

ORIGINAL

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission

v.

Docket No. R-00973954

Pennsylvania Power & Light Company

Application of PP&L for Approval
of its Restructuring Plan Under
Section 2806 of the Public Utility Code

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**JOINT MAIN BRIEF
OF LARGE CUSTOMERS**

PP&L INDUSTRIAL CUSTOMER ALLIANCE

Air Products and Chemicals, Inc.
Alumax
Appleton Papers Inc.
Armstrong World Industries, Inc.
Bethlehem Steel
CertainTeed Corporation
Hercules Cement Company
Hershey Foods Corporation
Horsehead Resource Development Co., Inc.
Lafarge Corporation - Whitehall Plant

Lucent Technologies
Magee Carpet Company
Mount Joy Wire Corporation
Praxair, Inc.
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The Stroh Brewery Company
Thomson Consumer Electronics, Inc.
Victaulic Company of America
WEA Manufacturing

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**UNITED STATES DEPARTMENT OF DEFENSE
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I. CONTEXT OF RESTRUCTURING¹

A. ECONOMIC AND COMPETITIVE BACKGROUND

Pennsylvania, once considered a keystone state for industrial production in the Eastern United States, suffered significant industrial contraction during the 1970's and 1980's as businesses migrated to states with lower production costs. Pennsylvania Governor Thomas J. Ridge and the Pennsylvania General Assembly recognized that Pennsylvania could regain its economic supremacy by offering to businesses a more cost-effective environment.

Governor Ridge and the General Assembly targeted competitive electricity generation supply as an avenue to decrease the costs of doing business in Pennsylvania. The Governor noted:

Low-cost electricity is an enormously powerful economic development tool. . . . When we embrace electric competition, we take another critical step in our quest to make Pennsylvania job-friendly.

"Inside the Capitol: Ridge Favors Free Market Electricity," Harrisburg Patriot & Evening News, Sept. 23, 1996, page B5, 1996 WL 5704407. Pennsylvania began this critical step towards greater economic prosperity with the enactment of the "Electricity Generation Customer Choice and Competition Act." P.L. 802, No. 1996-138 (1996), codified at 66 Pa. C.S. § 2801 et seq. ("the Act" or "Chapter 28").

The cost of electricity is a critical factor in business decisions regarding the siting of production facilities. 66 Pa. C.S. § 2802(6); See also PPLICA Statement No. 4, Direct Testimony of James H. Rooney, pp. 6-8 & PPLICA Statement No. 5, Direct Testimony of James S. Schneider, pp. 3 & 6. To enable Pennsylvania to compete on the national and international level for the attraction of new businesses and for the retention and expansion of existing businesses, the Governor and the Legislature concluded that introduction of competition in the electricity generation market was essential.

¹This portion of the joint large customer brief represents the litigation positions of the PP&L Industrial Customer Alliance ("PPLICA"). The United States Department of Defense and Federal Executive Agencies concur with this portion and offer an Appendix to the brief. (See Appendix A.)

66 Pa. C.S. § 2802(7). Businesses in Pennsylvania were faced with rates that were, on average, higher than those being charged to the average customer nationwide. Id. § 2802(5). Pennsylvania Public Utility Commission ("PUC" or "Commission") noted in its Report and Recommendation to the Governor and General Assembly on "Electric Competition",

One factor driving a move to restructuring is the disparity in electric rates and costs. There is a high disparity in retail electric rates across Pennsylvania and between Pennsylvania and many other states. As of January 1996, Pennsylvania residential electricity prices ranged from 6.69 to 11.58 cents per kwh. Industrial rates ranged from 4.53 to 7.13 cents per kwh. Nationwide, Pennsylvania rates are in the highest 25% of electricity rates when compared with all other states.

Investigation Into Retail Competition, Docket No. I-940032, Report and Recommendation to the Governor and General Assembly on Electric Competition adopted on July 3, 1996, p. 5 (citation omitted). The introduction of a competitive market will eliminate this unnecessary disparity in electricity prices because competition will better control the cost of electricity than continued economic regulation of generation supply. 66 Pa. C.S. § 2802(5). The elimination of the disparity between the electricity rates in Pennsylvania and the nation will enable Pennsylvania to attract and retain the businesses necessary for continued and increased economic prosperity.

The Governor and the Legislature also acknowledged that businesses in Pennsylvania face significant variations in the rates charged by the various utilities. Id. § 2804(4). The Commission must take this factor into account in its decisions implementing the Act. Because of the existence of a transition period during which the Pennsylvania utilities may be permitted to recover stranded costs, the establishment of direct access for 100% of consumers will not, by itself, eliminate the price disparities between Pennsylvania utilities. Part of the disparity cannot be eliminated during the transition period because customers will face different levels of stranded cost responsibility based on the established stranded costs for their electric distribution utility. This Commission, however, can eliminate the

remaining disparity by adopting a uniform market price projection and stranded cost calculation methodology for the utilities in the PJM power pool (PP&L, PECO, and GPU). The adoption of a uniform market price projection and stranded cost calculation methodology for the PJM utilities will place customers on equivalent footing when shopping in the competitive market because each will have the same target market price and stranded cost responsibility based on a consistent methodology.

In addition, adoption of a uniform market price projection and stranded cost calculation methodology will ensure that each utility's generation is valued using an equivalent standard. Equity demands that in determining each utility's stranded costs, no company should be benefitted through excess stranded cost recovery because the total was computed using a different (likely lower) market price projection than the other utilities in the same market.² Furthermore, choice of a different calculation methodology will result in disparate "stranded" valuations of otherwise comparable generation assets facing identical market conditions. This unwarranted and inequitable difference in "stranded" valuation of otherwise comparable assets unreasonably harms ratepayers, competitors, and other utilities in violation of Section 2802(8) of the Act, 66 Pa. C.S. §2802(8).

B. LEGAL AND LEGISLATIVE BACKGROUND

The Governor and General Assembly realized that the United States is on the cusp of widespread competition in the retail electric generation supply market. 66 Pa. C.S. §§ 2802(2) & (3). The FERC introduced competition in the wholesale electricity industry by requiring transmission utilities to offer open access transmission through their service territories for wholesale transactions. Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order 888, 61 FR

²The correlation between assumed market price and the level of stranded costs will be discussed in detail in Section IV, infra.

21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), Order on reh'g, Order No. 888-A, 62 FR 12,274 (Mar. 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), Order on reh'g, Order No. 888-B (issued Nov. 25, 1997) (hereinafter collectively "FERC Order 888"). Previously, although a customer could purchase wholesale supply from a supplier other than their local distribution company, the customer could not force the local distribution utility to permit the electricity to flow to customer's premises. The FERC now requires transmission utilities to submit a pro forma tariff guaranteeing such access on reasonable and non-discriminatory terms.

In addition, many states are introducing competition in the retail electricity generation supply market. For example, California, Illinois, New Hampshire, Maine, Nevada, Montana and Oklahoma have passed legislation requiring competition in the electricity market. Countless other states have legislation or regulations pending to provide customers with access to competitive generation supply.

A tremendous opportunity will accrue to the states that are able to implement a viable restructuring effort earliest in the national movement. Each year business decisions are made regarding the siting of new plants or the continued viability of existing plants. Having in place a restructured electric generation environment with the accompanying lower electricity costs will attract and retain those plants to Pennsylvania. As noted by Governor Ridge:

Deliberate and thoughtful implementation of retail electric competition will send a clear message around the entire country that Pennsylvania is a leader.

"Inside the Capitol: Ridge Favors Free Market Electricity," Harrisburg Patriot & Evening News, Sept. 23, 1996, p. B5, 1996 WL 5704407. The Commission is now faced with the responsibility to ensure that implementation furthers the pro-business customer and pro-competitive intentions of the Act.

C. ELECTRICITY GENERATION COMPETITION AND CUSTOMER CHOICE ACT

1. Concerns Addressed By The Customer Choice Act

Factors leading to enactment of the Act centered around the concept that the regulated structure in Pennsylvania could not provide businesses with the low-cost electricity central to business siting and retention decisions. 66 Pa. C.S. §§ 2802(3) through (9). Simply stated, Pennsylvanians are paying unjustifiably high prices for electricity. In energy intensive industries, the price disparity could influence a decision to do business in Pennsylvania. The loss of these businesses to states with lower electricity prices detrimentally impacts the welfare of all citizens in this Commonwealth. The Act addressed these economic concerns by providing retail customers (both business and residential) with direct access to the distribution system of the local utility in order to transport generation supply purchased in the competitive marketplace. Id. § 2802(12).

2. Post-Restructuring Electricity Market Envisioned By The Customer Choice Act

The Act is structured such that true competition will most likely not occur on day one. The Act provides a phase-in schedule that limits participation in the competitive market to a certain percentage of peak load for each customer class as of certain target dates. Id. § 2806(b). All customers must have access for 100% of their load on January 1, 2001. Id. In addition, the Act provides a transition period for the utility to recover stranded costs that the utility can demonstrate are just and reasonable to recover from ratepayers. Id. § 2808(a). This transition period is limited to the lesser of nine years or the period necessary for the utility to recover stranded costs through a competitive transition charge ("CTC"). Id. § 2808(b). True competition in Pennsylvania must await the completion of this transition period, when the consumers will be able to make supply and demand decisions unfettered by the consideration of payments for stranded costs. See Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial

Settlement & Petition of Enron Energy Services Power, Inc. for Approval of an Electric Competition and Choice Plan and for Authority Pursuant to Section 2807(E)(c) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Opinion and Order entered on Dec. 23, 1997, slip op. at 15 & 30 ("PECO Restructuring Order") (acknowledging the significant government intrusion in the competitive market during the transition period necessitated under Chapter 28).

II. LEGAL AND POLICY FOUNDATIONS OF STRANDED COST RECOVERY

A. LEGAL STANDARD

The Commission must adhere to two primary sources of guidance when making the stranded cost determination in this proceeding. First, the Commission must follow the dictates of the Public Utility Code, 66 Pa. C.S. § 101, et seq., and the specific standards for the restructuring of the electric industry embodied in Chapter 28 of that Code, 66 Pa. C.S. § 2801, et seq. ("Chapter 28" or "Act"). Second, the Commission must acknowledge its own precedents implementing the Act or addressing issues underlying stranded cost recovery. Consistency in treatment among electric utilities is essential, particularly in the area of market price forecasts used to calculate stranded costs for utilities in the same market (i.e. PJM).

1. Statutory

Four sections of Chapter 28 provide the foundation for the determination of PP&L's stranded cost recovery. Section 2803 provides a definition of "stranded costs." Sections 2802 and 2804 explain the Commission's duty with respect to the issuance of a competitive transition charge and determining the level of recoverable stranded costs. Section 2808 establishes principles that the Commission must follow to quantify the amount of different categories of stranded costs to be recovered from ratepayers

through the CTC.³ Read together, Chapter 28 mandates a three-step process for the Commission to determine the amount of a utility's recoverable stranded costs from ratepayers.

First, the Commission must determine whether the utility's purported "transition or stranded costs" are properly claimable under Chapter 28. In arriving at this determination, the Commission must interpret and apply the standards for electricity restructuring in Section 2804 and the following definition of "transition or stranded costs" in Section 2803.

An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the Commission determines will remain following mitigation by the electric utility.

Id. § 2803. This definition provides at least the following five requirements for a cost to be considered a stranded cost: (1) generation related; (2) known and measurable; (3) netted against all other generation-related costs; (4) traditionally recoverable in a regulated environment, but not recoverable in a competitive market; and (5) determined by the Commission to be remaining after mitigation. Only costs that satisfy all five criteria are properly claimable as stranded costs under the Act. Id.

Second, the Commission must determine the correct quantification of the properly claimable stranded or transition costs. The Commission must weigh the evidence presented in the proceeding and determine whether the Company has met its burden of proof with respect to the proper amount to be considered for recovery. Id. §§ 315(a) & 332(a). The utility must show its claim to be known and measurable. Id. § 2803. For example, if the utility claims \$400 million in NUG-buyout costs but can

³Ultimately, all provisions of the Public Utility Code must be read together to govern the Commission's decision in this proceeding, including Chapter 28 (relating to the introduction of competition for electric generation supply) and Section 1301 (relating to the Commission's duty to ensure just and reasonable rates).

only satisfy the burden of proof that \$350 million are owed to NUG operators, then only \$350 million should be considered by the Commission for recovery as stranded costs. In addition, the Commission must ensure that the stranded costs are valued on a net present value basis. Id.

Third, the Commission must determine the just and reasonable amount of properly claimable, properly quantified stranded costs to be recovered from ratepayers through the CTC. Id. § 2804(13). Utilities have the opportunity to recover a just and reasonable level of qualifying stranded costs via a competitive transition charge ("CTC") paid by customers accessing the utility's transmission and distribution network. Id. §§ 2802(15) & 2808(a). The Act places upon the Commission a specific duty with respect to approval of a CTC. **The Commission has the power and duty to approve a CTC only for the amount of transition or stranded costs it determines to be just and reasonable to recover from ratepayers.** Id. § 2804(13); PECO Restructuring Order, slip op. at 63-68; Application of PECO Energy Company for Issuance of a Qualified Rate Order under Sections 2808 and 2812 of the Public Utility Code, Docket No. R-00973877, Statement of Commissioner John Hanger, issued at polling session conducted at Public Meeting on May 8, 1997 ("Hanger QRO Statement") (attached as Appendix E). Thus, in determining the level of transition or stranded costs recoverable from ratepayers the Commission must exercise its regulatory discretion to strike an appropriate balance between the interest of shareholders, ratepayers, and new competitive market entrants. 66 Pa. C.S. § 2802(8); Pennsylvania Pub. Util. Comm'n v. Pennsylvania Gas & Water Co., 492 Pa. 326, 424 A.2d 1213 (1980), cert. denied 454 U.S. 824 (1981).

Section 2803 also establishes three broad categories of potential stranded costs: (1) net plant investments and costs attributable to a utility's existing generation plants and facilities ("stranded generation"); (2) regulatory assets and other deferred charges typically recoverable under current regulatory practice ("regulatory assets"); and, (3) non-utility generation contract buyout costs ("NUG

costs"). 66 Pa. C.S. § 2803. The Act provides guidance with respect to specific standards for the quantification of and level of recovery for the three categories of stranded costs. Id. § 2808(c). An application of the above-explained three-step process to each category follows.

a. Stranded Generation Costs

The largest category of stranded costs, "stranded generation costs," encompasses a broad spectrum of generation-related costs that the utility can show were traditionally recoverable in the regulated environment but may not be recoverable in the competitive market. Id. § 2803.

In order to be properly claimable as a stranded generation cost, the cost must be included in one of the categories established in the Act. These categories include: (1) net plant investments and costs attributable to existing generation plant and facilities; (2) disposal of spent nuclear fuel; (3) long-term power purchase commitments other than non-utility generator contracts; (4) retirement costs not included in net plant investments; and, (5) transition costs such as employee severance. Id. In addition, the utility's costs must meet the general claimability criteria under the definition: the costs must be known and measurable; the costs must have been prudently incurred and not previously disallowed by the Commission; and, the costs must remain after mitigation. Id.

Once it has been determined which of the utility's claims properly qualify as potential stranded generation costs, the Commission must quantify the appropriate value of the Company's investment that is "stranded" because of the transition to retail competition. Id.; PECO Restructuring Order, slip op. at 67-68 & 80-88; Hanger QRO Statement, p. 7. This must be done in accordance with the definition of "stranded cost" contained in the Act; i.e., the cost must be known and measurable, the cost must be typically recoverable in a regulated environment but not recoverable in a competitive market, the amount of the cost is determined on a net present value basis over the life of the asset, and the cost is netted against any benefits from the movement to a competitive market. Id. The only appropriate

method to quantify the level of stranded generation costs is the "Asset Value Method," which compares PP&L's net generating plant balance at December 31, 1998, to the market value of PP&L's units in the competitive environment. See PPLICA Statement No. 1, Direct Testimony of Stephen J. Baron, pp. 20-21; PPLICA Statement No. 2, Direct Testimony of Randall J. Falkenberg, pp. 10-11. The Commission adopted the Asset Value Method in determining the generation related stranded cost to be recovered by PECO Energy Company ("PECO"). PECO Restructuring Order, slip op. at 80. The Commission must be consistent in all Pennsylvania utilities' restructuring proceedings on the critical issue the methodology for determining the amount of generation-related stranded costs the utility will be permitted to recover during the transition period.

After determining the amount of properly claimable and quantified stranded generation costs, the Commission must establish a just and reasonable portion to be recovered from ratepayers through the CTC. 66 Pa. C.S. § 2808(c)(3). With respect to properly claimed and quantified regulatory assets and NUG costs, the Act suggests that the "Commission shall allow recovery" (Id. § 2808(c)(1) and (2) (emphasis added)); however, the Act states that the "Commission shall determine the level of other generation-related transition or stranded costs that may be recovered through the competitive transition charge." Id. § 2808(c)(3) (emphasis added). This section, along with the Commission's duty to ensure that the level of transition costs recovered from ratepayers is "just and reasonable" (Id. §§ 2804(13) & 1301) and "appropriate" (Id. § 2802(15)) mandates that the Commission use its regulatory discretion in setting the amount of properly claimed and quantified generation-related stranded costs recoverable from ratepayers. See Hanger QRO Statement.

If stranded generation costs were to be treated the same as regulatory assets and NUG buyout costs, then the Legislature would have used the identical language to describe all three types of costs. This interpretation is clearly the most reasonable. The Legislature's clear words on this issue cannot

be ignored. 1 Pa. C.S.A. § 1921(b). The Commission need not allow recovery through the CTC of all properly claimed and quantified generation-related stranded costs.

The appropriate mechanism for the Commission to affect the mandated balancing between the interests of shareholders and ratepayers in setting the just and reasonable recoverable level of generation-related stranded costs is via an "equity return disallowance." The equity return disallowance compares the present value of revenue requirements associated with stranded generation costs (at a fully grossed up return level with a common equity return component) to a similar calculation without a common equity return component. PPLICA Statement No. 1, p. 12.

The Commission previously used an equity return disallowance on assets that were not used and useful. See Pennsylvania Pub. Util. Comm'n v. Pennsylvania Power & Light Co., Docket No. R-842651, Order entered on April 26, 1985, 59 Pa. P.U.C. 332, affirmed 101 Pa. Commw. 370 (1986) (disallowing return on common equity associated with Susquehanna Unit 2 because the unit was excess capacity). Stranded generation costs are, by analogy, no longer used and useful in the competitive market environment because stranded assets do not provide electric utility service. PPLICA Statement No. 1, pp. 16-17. The equity return disallowance is a reasonable approach for making the necessary adjustment to uneconomic generation costs in order to arrive at a just and reasonable level to recover from customers. Id. at 19. Based on the PPLICA recommended level of stranded generation costs, the equity return disallowance should be \$47.482 million. Id. at 13.

b. Regulatory Assets and Liabilities

The second category of potentially recoverable stranded costs is "regulatory assets and liabilities." 66 Pa. C.S. § 2803. Regulatory assets are past costs incurred by regulated utilities that the Commission has specifically stated the utility can recover from ratepayers in the future. PP&L Statement No. 8, Direct Testimony of Joseph R. Schadt, p. 20. Claimable stranded regulatory assets

must be known and measurable and typically recoverable under current regulatory practice. 66 Pa. C.S. § 2803.

Next, the Commission must quantify the amount of properly claimed regulatory assets. The valuation of any properly claimable regulatory assets must be on a net present value basis. Id. In addition, the Act provides recovery only for the utility's "net electric generation-related costs" stranded by the transition, including regulatory assets. Id. Netting regulatory assets and regulatory liabilities is a prerequisite for the Commission to ensure that any amount of recovery from ratepayers authorized by the Commission is just and reasonable. Id. §§ 2804(13) & 2804(14). It would be wholly inequitable and violative of Chapter 28 (as well as Section 1301) if regulatory assets were included in the CTC stranded cost computation without recognizing the offsetting values of PP&L's regulatory liabilities; in short, absent a netting of known and measurable assets against liabilities, PP&L's transition or stranded cost claim will be inflated and result in the payment of unjust and unreasonable stranded cost charges. The objective of the statute is to ensure that neither the Company nor ratepayers are unjustly harmed. Id. § 2804(8). Netting of regulatory assets and liabilities is necessary to fulfill this objective.

Section 2808 provides that all appropriately quantified net stranded regulatory assets can be recovered from ratepayers through the CTC. Id. § 2808(c)(1).

c. NUG Buy-Out Costs

The EDC may make a stranded cost claim for recovery of "prudently incurred costs related to cancellation, buyout, buy down or renegotiation of non-utility generating projects" ("NUG buy-out costs"). Id. § 2803. NUG buy-out costs must also satisfy the general definition of stranded costs. NUG buy-out costs must be properly claimable; i.e., known and measurable, prudently incurred, and typically recoverable in regulated environment. Id. NUG buy-out costs must also be quantified correctly. Id. This mandates that the costs be stated on a net present value basis and be netted against any benefits that

result from the buy-outs. Id. As with regulatory assets, properly claimed and quantified NUG buy-out costs can be fully recovered through the CTC. Id. § 2808(c)(2).

2. Regulatory

Some of the issues in this proceeding are not issues of first impression for the Commission. The Commission's previous Orders and Opinions regarding the PECO restructuring proceeding, the PECO request for a Qualified Rate Order and other generic dockets provide guidance on some issues. Specifically, the Commission has previously addressed the following issues:

- (a) the burden of proof for the stranded cost determination;
- (b) the proper method for determining an appropriate level of recoverable stranded costs from ratepayers;
- (c) the proper allocation of universal service charges;
- (d) the appropriateness of recovery for future fossil decommissioning costs;
- (e) the calculation of the CTC applicable to interruptible customers;
- (f) the preferable schedule for the phase-in of direct access;
- (g) the selection of industrial customers for the phase-in of direct access;
- (h) certain types of regulatory assets and liabilities; and
- (i) the market price for the PJM region.

PPLICA positions in this proceeding are thoroughly consistent with the precedent on these issues. Fairness for all persons and entities effected by electricity restructuring mandates consistency by the Commission on a state-wide basis or regional basis (i.e., PJM or ECAR) for resolution of these issues. 66 Pa. C.S. §§2804(14) & 2802(8).

a. Burden of Proof for Stranded Cost Determination

The PECO decision established the following burden of proof for the stranded cost determination:

In summary, in order to recover each component of the requested amount, PECO has the burden to prove, based on substantial evidence in the record, that each request would recover the net present value of the unmitigated, net, known and measurable generation related expense within the definition of stranded costs. PECO has the burden to prove that such costs would have been recoverable under traditional regulation but will not be recoverable in a competitive market.

PECO Restructuring Order, slip op. at 68. Obviously, the same standard, with the burden of proof based on substantial evidence, must be placed on PP&L in this proceeding. As demonstrated throughout this brief, PP&L failed to satisfy this burden on numerous stranded cost claims, and the Commission must deny recovery for those claims.

b. Determination of Recoverable Stranded Costs

The Commission addressed the standards for determining stranded costs in the PECO QRO proceeding and the PECO restructuring proceeding. The Commission stated that “we are guided by the Act’s standards which provide that any amount of stranded investment that is allowed for recovery must be (1) known and measurable; (2) calculated at the net present value; (3) just and reasonable; and (4) in the public interest. 66 Pa. C.S. §§ 2804, 2812.” Application of PECO Energy Company for Issuance of a Qualified Rate Order under Sections 2808 and 2812 of the Public Utility Code, Docket No. R-00973877, Opinion and Qualified Rate Order entered on May 22, 1997, 177 PUR 4th 417, 427 (1997) (“PECO QRO Order”). PPLICA’s calculation of stranded costs in this proceeding is fully consistent with the Commission’s standard.

The Commission endorsed a differing treatment for the determining recoverable stranded generation costs (as opposed to regulatory assets and NUG costs) in the PECO restructuring proceeding.

In contrast to Section 2808(c)(1) and (2) claims that are fully recoverable, once a Section 2808(c)(3) claim is proven to exist as a stranded cost within the definition in the Act, the Commission must authorize a "just and reasonable" amount for recovery.

PECO Restructuring Order, slip op. at 67. Thus, the Commission has endorsed the multi-step process for stranded cost claimability, quantification, and recoverability discussed previously.

Commissioner John Hanger further detailed the mechanics of the stranded cost analysis required for regulatory assets, NUG costs and generation plants.

The Act establishes different standards for stranded investment recovery depending on whether the stranded investment at issue is a regulatory asset or generation plant investment. If stranded investment results from regulatory assets or PURPA contracts, the Act requires the Commission to allow recovery of that amount that is known and measurable and calculated on a net, present value basis amount.

If the stranded investment claim involves generation plant investment, the Act requires the Commission to conduct a two-step analysis. First, the Commission must determine how much of the claim is known and measurable and to calculate the amount on a net present value basis. Once the Commission identifies an amount of stranded generation plant that is known and measurable and calculated on a net, present value basis, the Act requires the Commission to decide how much of that total would be "just and reasonable" to allow shareholders to recover.

Hanger QRO Statement, p. 7. Commissioner Hanger's first step equates to determining whether the utility's claim is proper under the Act (whether the cost is claimable) and whether the claim is correctly quantified. Commissioner Hanger's second step is determining a just and reasonable amount of properly claimable and quantified stranded costs to recover from ratepayers. This is exactly the multi-step approach adopted in the PECO restructuring decision and endorsed by PPLICA herein. The Commission must adhere to the precedent established in the PECO QRO and restructuring proceedings by applying the multi-step process for stranded cost claimability, quantification, and recoverability.

Moreover, the Commission recognized that in discharging its duties to ensure that the level of stranded cost recovery is just and reasonable and in the public interest, it must be concerned with "balancing ... the interests of shareholders, ratepayers, and new entrants to the market." PECO QRO

Order, 177 PUR 4th at 427; see PECO Restructuring Order, slip op. at 100-101. The Commission specifically relies the case law regarding its administrative expertise and discretion with respect to determining just and reasonable rates as an explanation of the boundaries of its discretion to accomplish this balancing. Id.; PECO Restructuring Order, slip op. at 64. That case law represents another source of guidance for the Commission in ensuring that the transition will be accomplished in a manner that is fair to ratepayers and shareholders. 66 Pa. C.S. §§ 2804(14) & 2802(8).

c. Allocation of Universal Service Program Costs

The Commission has also instituted several generic proceedings to address issues that should be decided uniformly on a state-wide basis. On July 11, 1997, the Commission issued a Final Order regarding universal service issues. Final Order re: Guidelines for Universal Service and Energy Conservation Programs Made Pursuant to 66 Pa. C.S. §2803, §2802(17), 2804(8) and 2804(9), Docket No. M-960890F00010, Order entered on July 11, 1997 ("Universal Service Order"). Universal service was addressed in a generic proceeding because "the subject matter of these guidelines requires consistent policy determinations to be applied across the local distribution service territories." Id., slip op. at 2.

The Commission was explicit regarding cost recovery for universal service programs. Id. Universal service program costs cannot be allocated to customers on a per kWh-basis. Id. In applying the requirements of the Act and of the Universal Service Order in the PECO restructuring proceeding, the Commission held that universal service costs must be allocated to customers for recovery based on the allocation used in PECO's last base rate proceeding. PECO Restructuring Order, slip op. at 146.

The Commission's determination in this regard is fully supported by the Act. First, the Act prohibits inter- and intra-class cost shifting. 66 Pa. C.S. §§ 2808(a) & 2804(7). The mechanism to ensure that such cost-shifting does not occur is to maintain consistency with the allocation for these costs used in the utility's last base rate case. Id. The Commission recognized this necessity in its Universal

Service Order wherein it stated that “[a]ssessing a funding mechanism on kWh use is inconsistent with rate treatments for these programs in recent base rate cases.” Universal Service Order, slip op. at 20. Second, universal service costs are a component of current bundled rates. 66 Pa. C.S. § 2802(17). As those rates are being unbundled, the non-generation portion of the rates, including the portion devoted to universal service costs, is subject to a rate cap for 54 months to the termination of CTC recovery by the utility. Id. § 2804(4)(i)(B). All components of the capped rates are unbundled based on the Company’s cost of service study. Because universal service costs are one component of bundled rates, a specific amount is embedded in current rates for universal service costs. Increasing that allocation violates both the total rate cap and the individual component rate cap established under the Act. Id.⁴

PPLICA (and PP&L) advocate universal service recovery based on the allocation currently embedded in each customer class’s bundled rates as determined in the last base rate proceeding. PPLICA Statement No. 1R, Rebuttal Testimony of Stephen J. Baron, pp. 3-10; PP&L Statement No. 9R, Rebuttal Testimony of Susan F. Tierney, pp. 38-39. As such, the proposals are fully consistent with the Act, the Universal Service Order, and the PECO restructuring decision.

d. Recovery of Future Fossil Decommissioning Costs

In the PECO restructuring decision, the Commission rejected a claim for recovery as stranded costs of future fossil decommissioning expenses because the costs fail to satisfy the known and measurable requirement under the definition of stranded cost and because the costs would not be typically recoverable in a regulated environment. PECO Restructuring Order, slip op. at 91-92. The

⁴The overall rate cap (66 Pa. C.S. § 2804(4)) and the prohibition against cost shifting (66 Pa. C.S. §§ 2808(a) & 2804(7)) mandate a cap on the individual rate components at their 1/1/97 levels. It is simply not possible to change the individual allocation currently within rates without violating one provision or the other. An increase in one allocation will either result in the exceedence of the rate cap or the need to reduce some other component of the formerly bundled rate. The reduction in that component must be shifted to another rate class if the Company is to recover its full cost of service.

Commission relied on an extensive line of precedent in denying PECO's claim. PPLICA advocates rejection of an identical claim made by PP&L.

e. Calculation of CTC for Interruptible Customers

In its restructuring filing, PECO proposed to limit the availability of interruptible service only to customers that remain on bundled interruptible service. If a current interruptible customer sought alternative supply, PECO proposed to charge that customer transmission, distribution and CTC charges based on a firm rate schedule. The Commission rejected the PECO proposal because "[t]here is no statutory suggestion that any class of customers can be denied the opportunity to shop." *Id.* slip op. at 118. The PPLICA arguments in this proceeding for rejection of a similar proposal are fully consistent with this precedent. *See, infra*, Section VII.F.

f. Schedule for Phase-in of Direct Access

In the PECO restructuring decision, the Commission adopted an accelerated schedule for the phase-in of direct access that makes 33% of each customer class's peak load eligible for direct access on January 1, 1999, 66% of each class's peak load eligible on January 2, 1999, and 100% eligible on January 2, 2000. PECO Restructuring Order, slip op. at 46-49. The Commission recognized that the accelerated phase-in is permissible under the Act and is in the public interest. *Id.* PPLICA proposes an identical schedule for the phase-in of direct access.

g. Selection of Industrial Customers for Stages of Phase-In of Direct Access

The determination of which customers will participate in the first two stages of the phase-in of direct access is critical. Competitive disadvantages may result if a business cannot participate in direct access while its competitors can. The Commission is permitting all industrial customers in the PECO service territory to participate in the first and second stages of phase-in. Application of PECO Energy

Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement & Petition of Enron Energy Services Power, Inc. for Approval of an Electric Competition and Choice Plan and for Authority Pursuant to Section 2807(E)(c) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company, Docket Nos. R-00973953 & P-00971265, Opinion and Order on Reconsideration entered on Jan. 16, 1998, slip op. at 22 ("PECO Restructuring Reconsideration Order") (attached as Appendix F). The PPLICA proposal for industrial customer phase-in for the PP&L service territory is identical to the Commission's actions in the PECO restructuring decision.

h. Regulatory Assets and Liabilities

The Commission has previously considered issues regarding the claimability and quantification of several regulatory assets that are also contested in this proceeding. These regulatory assets include SFAS 109, Unrecovered Energy Costs, and SFAS 106. PECO Restructuring Order, slip op. at 68-72. PPLICA's treatment of these regulatory assets is consistent with the Commission's decision in the PECO restructuring proceeding. In addition, the PECO decision mandated recognition of several regulatory liabilities that are also applicable in this proceeding. Id., slip op. at 76-77. PPLICA's advocacy for recognition of regulatory liabilities in PP&L's stranded cost calculation is consistent with this precedent.

i. Market Prices for the PJM Region

In deciding the amount of stranded generation costs recoverable by PECO, the Commission implicitly adopted the market price analysis performed by the OCA. PECO Restructuring Order, slip op. at 82-90. This market price analysis predicted the future market prices for the PJM region. Because future market price is a key factor in the restructuring decision, the Commission should apply the OCA market price analysis in determining stranded generation costs for all utilities in the relevant PJM region.

PPLICA recognizes this need for consistency by agreeing to accept use of the OCA market price forecast (which is identical in both the PP&L and the PECO proceedings).

* * *

PPLICA is not addressing the following sections: II.B, II.C, II.D.1. PPLICA reserves the right to respond, as appropriate, in reply brief on these topics.

* * *

D. MITIGATION

2. Post-Restructuring Mitigation

a. Foregone Recovery Under Rate Cap

PP&L posits that its foregone recovery under the rate cap of approximately \$400 million in stranded costs represents a type of mitigation pursuant to the Act. PP&L Statement No. 2, p. 18. Foregone recovery under the rate cap should not be considered a legitimate way for PP&L to fulfill its mitigation duties. EDCs are to be provided with "an opportunity to recover . . . transition or stranded costs," not with a guarantee of recovery. 66 Pa.C.S. § 2808(a). Foregone recovery is expected by the Act. PP&L witness Dr. Kalt recognizes this fundamental assumption of the Act that "the recovery of stranded costs is constrained both in time and in amount." PP&L Statement No. 1, Direct Testimony of Dr. Joseph P. Kalt, p. 16. In addition, if the Commission accepts PPLICA's stranded cost calculation (which it should) or the OCA calculation, PP&L will experience no such foregone recovery. PPLICA Statement No. 1, p. 31.⁵ In such event, PP&L's claims of foregone recovery cannot legitimately be considered to be a method of mitigation.

* * *

⁵If the Commission adopts the PPLICA stranded cost calculation, PP&L would recover its entire stranded cost revenue requirement by November 1999. PPLICA Statement No. 1, p. 31.

PPLICA is not addressing sections II.D.2.b through II.D.2.g. PPLICA reserves the right to respond to other parties' arguments on these issues in reply brief.

* * *

E. ALLOCATION OF STRANDED COSTS

Some parties assert that PP&L inappropriately treats stranded costs as a component of current bundled rates and propose instead to allocate stranded costs to rate classes based on consumption. See Environmentalists Statement No. 1, Direct Testimony of David Schoengold, p. 28; AARP Statement No. 1, Direct Testimony of Dr. Mark N. Cooper, p. 32. These proposals constitute irresponsible and blatant violations of Chapter 28. Moreover, it is improper to treat costs related to production demand (such as stranded generation-related costs) on an energy basis. The costs must be allocated consistent with the treatment in the last PP&L base rate proceeding.

The Act specifically mandates how stranded costs are to be allocated to rate classes.

The costs to be recovered shall be allocated to customer classes in a manner that does not shift interclass or intraclass costs and maintains consistency with the allocation for utility production plant accepted by the Commission in the electric utility's most recent base rate proceeding.

66 Pa. C.S. § 2808(a). The PP&L proposed allocation method treats stranded costs as a portion of bundled production demand-related costs and consequently unbundles stranded costs based on the 12 CP (12 coincident peak) methodology. PP&L Statement No. 2, Direct testimony of Joseph M. Kleha, p. 7. The 12 CP Method allocates costs based on the "average of the twelve monthly class demands coincident with the time of the system monthly peak load." Id.

The PP&L proposed methodology satisfies both the Act's criteria. First, the PP&L methodology is consistent with the allocation for utility production plant in the utility's most recent base rate proceeding; i.e., the 12 CP methodology is used for both. Id.; Pennsylvania Pub. Util. Comm'n v.

Pennsylvania Power & Light Co., Docket No. R-00943271, Opinion and Order entered on Sept. 27, 1995, slip op. at 197, 1995 Pa. PUC LEXIS 189 at *283 (1995) ("1995 PP&L Base Rate Order"). The Commission stated that it was adopting the 12 CP methodology because the "method has served to accurately reflect allocation of generation and transmission costs for PP&L." Id. This method must be carried forward to the recovery of stranded costs under Chapter 28. 66 Pa. C.S. § 2808(a). Second, allocating stranded costs on a 12 CP basis prevents any impermissible or unlawful cost shifting. The rates that are being unbundled in this proceeding were established in the 1995 base rate proceeding by applying the 12 CP methodology to production-related costs. Any attempt to unbundle the rates and allocate additional costs to rate classes using an allocation methodology other than 12 CP will shift the responsibility. PPLICA Statement No. 1R, p. 11. This shift in allocation will violate the Act's specific mandate that decisions with respect to the transition not harm any set of customers to benefit utilities, shareholder, or other customers. 66 Pa. C.S. §§ 2802(8), 2804(7), & 2808(a).

The allocation of stranded costs based on energy use is clearly violative of the requirements of Chapter 28 and must be rejected.

III. STRANDED COST CALCULATION METHODOLOGY

Parties are advocating multiple proposed methods to calculate stranded costs. PPLICA calculates PP&L's stranded costs based on the "Asset Value Method." The Asset Value Method is the only method that is consistent with Chapter 28. The Regulatory Method used by PP&L clearly violates the definition of "stranded costs" in the Act and seeks to insulate PP&L shareholders from all effects of restructuring. Because this insulation is accomplished at the expense of ratepayers, use of the Regulatory Method violates the balancing necessary under the Act.

Based on the application of the Asset Value Method of stranded cost valuation and the PPLICA market price forecast, PP&L has claimable generation stranded costs under the Act of \$798 million.

PPLICA Statement No. 2S, Surrebuttal Testimony of Randall J. Falkenberg, p. 3, Exhibit No. RJF-9a-Revised. This is the proper quantification of generation stranded costs for the Commission to consider for recovery through the CTC.

The same calculation method and market price projections must be used for PP&L as were used for the PECO. Both companies are members of the PJM power pool. Consequently, absent location differences (which even PP&L's Dr. Jones asserts are not substantial in the PJM area), both companies face the same market prices and conditions in the future. PPLICA Statement No. 2, p. 10. To ensure an orderly transition to the competitive market, the Commission must treat the companies similarly.

The Commission adopted the Asset Value Method for determining stranded generation costs in the PECO restructuring proceeding (PECO Restructuring Order, slip op. at 80) and specifically rejected the Regulatory Method's lost revenues approach as "inappropriate." Id. n. 71. In order to implement electricity restructuring in a manner that is fair to all ratepayers, utilities, and competitors, the Commission must use the Asset Value Method to determine stranded generation costs for each utility in the Commonwealth. In addition, the Commission adopted a market price forecast for the PJM region in the determination of PECO's stranded generation costs. Although PPLICA's market price projections for the PJM region are reasonable, fairness and consistency require that the OCA market price projection be used for determining the stranded costs of all PJM utilities. PPLICA is willing to accept a consistent decision for the PJM utilities' restructuring proceedings with respect to use of the OCA market price projection. Absent such consistency, PPLICA maintains the legitimacy of its market price forecasts.

A. REGULATORY METHOD

PP&L calculated the generation-related portion of its \$4.5 billion in claimed stranded costs based on the "Regulatory Method." The Regulatory Method must be rejected because it is inconsistent with the definition of "stranded costs" under the Act and because it results in an inflated stranded cost

quantification that will unjustly enrich PP&L's shareholders at the expense of the ratepayers. Furthermore, the Regulatory Method is inconsistent with the approach adopted by the Commission in the PECO restructuring decision. See PECO Restructuring Order, slip op. at 80. The method for calculating stranded generation costs is a fundamental issue of electricity restructuring that must be applied consistently throughout all restructuring proceedings in order to treat ratepayers, utilities and competitors on a fair and non-discriminatory basis. See 66 Pa. C.S. §§ 2804(14) & 2802(8).

The Regulatory Method permits PP&L shareholders to avoid all consequences of restructuring by computing stranded costs as if traditional regulation continued through the life of each facility. The methodology involves the following steps:

- (1) Project price of electricity that will occur in competitive market.
- (2) Determine revenues that generating units will receive based on projected market price.
- (3) Project the annual revenue requirements that each unit would receive under traditional regulation.
- (4) *Calculate stranded costs based on difference between annual revenue requirements and projected revenues in the competitive market.*
- (5) Apply PUC jurisdictional percentage.
- (6) Discount to present value.

PP&L Statement No. 8, Direct Testimony of Joseph R. Schadt, p. 4; See also PP&L Statement No. 1, p. 17. The distinguishing feature of the Regulatory Method is the continued use in the deregulated environment of revenue requirements that were central to ratemaking in the regulated context.

The Regulatory Method must be rejected because it is inconsistent with the definition of "stranded costs." Stranded cost are the "electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which

may not be recoverable in a competitive electric generation market." 66 Pa. C.S. § 2803 (emphasis added). The Regulatory Method guarantees shareholders recovery of revenues not otherwise guaranteed for recovery under traditional regulation; i.e., "a perceived right of shareholders to future revenue streams associated with a static form of regulation." PPLICA Statement No. 2, p. 11. A right to future revenue has never been guaranteed under traditional regulation and "revenue" cannot be found in Chapter 28's definition of stranded costs. Shareholders are guaranteed an opportunity to earn a return on their investment in rate base. See Duquesne Light Co. v. Barasch, 488 U.S. 299, 109 S.Ct. 609 (1989); Philadelphia Electric Co. v. Pennsylvania Pub. Util. Comm'n, 61 Pa. Commw. 325, 329, 433 A.2d 620, 623 (1981). The future revenue stream is not typically recoverable in the regulated environment and thus should not be considered in the stranded cost calculation. 66 Pa. C.S. § 2803. Otherwise, the Commission would be creating a new and greater guarantee in an allegedly competitive market than what PP&L has in the traditional regulated market!

In addition, the Regulatory Method violates the principle that the transition be accomplished in a manner fair to all parties. 66 Pa. C.S. §§ 2802(8) & 2804(14). Under the Regulatory Method, shareholders will be compensated as if restructuring never occurred. PPLICA Statement No. 2, p. 11. This inflated compensation occurs, however, at the expense of the ratepayers paying the CTC. This is not the balancing contemplated by the Act. 66 Pa. C.S. §§ 2802(8) & 2804(14).

The Regulatory Method of calculating stranded costs does not satisfy the dictates of the Act with respect to the definition of stranded cost and the balancing of interests necessary in the transition to the competitive market. Furthermore, in the PECO proceeding the Commission specifically stated that a lost revenues approach to stranded cost calculation was inappropriate on the basis of the arguments set forth above. PECO Restructuring Order, slip op. at 80, n. 71. The Regulatory Method is a blatant attempt by PP&L to maximize recovery at the expense of captive ratepayers and must be rejected.

B. ASSET VALUE METHOD

In choosing a methodology to calculate PP&L's stranded costs, the Commission must be mindful of its duty under the Act to balance the interests of shareholders and ratepayers. See Section II.A., supra. The "Asset Value Method" of stranded cost calculation is a most reasonable compromise of these competing interests and the only method contemplated by the Act. In addition, adoption of the Asset Value Method for calculation of PP&L's stranded costs will result in the consistency of approach necessary by the Commission on this issue.

The Asset Value Method determines the loss to PP&L if it would sell its generating assets at market price, without actually having the Company relinquish the assets and consummate a sale. PPLICA Statement No. 1, p. 21. The Asset Value Method computes the "loss" experienced by shareholders because of the movement to a competitive market by comparing an estimate of the market value of PP&L's assets under competition to the present value of those assets contained on PP&L's books. Id., p. 20; PPLICA Statement No. 2, p. 10. The general steps in this analysis are as follows:

- (1) Project price of electricity in competitive market.
- (2) Determine revenues for generating units based on projected market price and expected kWh output.
- (3) Determine market value of assets based on projected revenues minus variable operating expenses.
- (4) Determine stranded cost based on comparison of market value to book value.
- (5) Apply PUC jurisdiction percentage.
- (6) Discount to present value.

Id. This equates to the general process that a willing buyer would undertake before purchasing PP&L's assets; i.e., basing the bid price on what the unit will be able to earn in the competitive environment.

The Asset Value Method is fully consistent with the definition of stranded costs in Chapter 28.

The PP&L shareholders will be compensated for the reduction in the value of the property supporting their investment. The difference between the book value of the assets and the revenue that the units will earn for the PP&L shareholders in the competitive market is the "net generation-related cost" of the effect of restructuring on those generation assets. 66 Pa. C.S. § 2803. Under regulation, shareholders were given an opportunity to earn a just and reasonable return on the generation-related assets. PPLICA Statement No. 2, p. 11. Investors were guaranteed only a "return of" their investment; investors were not guaranteed a "return on" their investment. See e.g., Barasch, 488 U.S. 299, 109 S.Ct. 607 (1989); Philadelphia Electric Co., 61 Pa. Commw. at 329, 433 A.2d at 623 (emphasizing that removal of units from rate base represented a denial of a return on investment but not a denial of a return of investment). Thus, the Asset Value Method calculates stranded costs based on costs traditionally "recoverable under a regulated environment ... which may not be recoverable in a competitive environment," i.e., the return of the shareholders' investment and any diminution in the value caused by the transition to competition.

In addition, the Asset Value Method represents a just and reasonable way to balance the interests of shareholders against the interests of the other parties. 66 Pa. C.S. §§ 2802(8) & 1301. An implicit assumption in the Asset Value Method is that the book value of assets equals the present value of the future stream of revenue requirements under regulation that PP&L would otherwise have recovered. PPLICA Statement No. 1, p. 21. In other words, book value is equivalent to the compensation that PP&L shareholders would have received under traditional regulation. Consequently, by compensating shareholders based on the Asset Value Method, the shareholders will be made whole from any diminution in the value of PP&L property caused by the transition to a competitive generation market. This is the balancing of interests contemplated by the Act's just and reasonable requirements.

Furthermore, the Asset Value Method was used by the Commission to determine the amount of stranded generation costs that PECO will be permitted to recover. PECO Restructuring Order, slip op.

at 80. It will be unfair to PECO to permit PP&L to recover a comparably greater level of stranded costs because of the use of a different valuation methodology. It will also be unfair to PP&L's ratepayers to have to compensate PP&L for excessive stranded costs because of the use of a different valuation methodology. Finally, it will be unfair to alternative suppliers competing with PP&L for PP&L's competitive position in the market to be subsidized because of the use of a different valuation methodology. Chapter 28 mandates that the transition to a competitive market be accomplished in a manner that is fair to all consumers, utilities and competitors. 66 Pa. C.S. §§ 2802(8) & 2804(14). Fairness demands that the Asset Value Method be consistently applied in the valuation of stranded generation costs.

C. OTHER METHODS INCLUDING AUCTION OF GENERATING ASSETS

Some parties in this proceeding have advanced alternative methods for stranded cost calculation. Specifically, the Environmentalists propose an asset sale to determine generation-related stranded costs. Environmentalists' Statement 1, Direct Testimony of David Schoengold, pp. 12-15. Because the Act specifically states that the Commission "shall not require an electric utility to divest itself of facilities" this alternative should be rejected. 66 Pa. C.S. § 2804(5).

IV. MARKET PRICE OF ELECTRICITY

A. RELEVANT MARKET FOR ENERGY

The first step in the estimation of future market prices is to establish the "relevant market." PPLICA Statement No. 2, p. 13. The parties do not disagree on the relevant market. PP&L uses the PJM power pool as the relevant market. PP&L Statement No. 7, p. 9. PPLICA supports use of PJM as the relevant market, although forecasts of imports and exports to other regions must also be considered. PPLICA Statement No. 2, p. 13-14. In addition, no record evidence exists that a differently defined market would lead to substantially different results. Id.

The Commission must use the same relevant market and market price projection for each PJM utility. This consistency is necessary to ensure all utilities and ratepayers are treated properly and fairly during the transition. 66 Pa. C.S. § 2802(8). The PUC accepted the use of market prices projected by OCA using the ENPRO model in the PECO restructuring proceeding. PECO Restructuring Order, slip op. at 89-90. The ENPRO model used by OCA treats imports and exports to PJM as part of the relevant market. OCA Statement No. 2, Direct Testimony of Douglas C. Smith, p. 20. The same treatment for the relevant market should be afforded to the ratepayers, competitors and utilities in this proceeding.

B. PRICE OF CAPACITY

One component of the future market price for electricity is the price of capacity. Capacity costs are the fixed costs related to electric generators. PPLICA Statement No. 2, p. 12. Under competition, suppliers will enter a market only when market prices are sufficient to recover both the capacity costs and energy costs (variable costs) of a new generator. Id.

The Commission must consider three main points in determining whether to rely on a market price forecast. **First**, the Commission should examine whether the inputs used in the model are reasonable and are independently derived. **Second**, the Commission should determine whether the model structure is logical. **Third**, the Commission should examine whether the results produced by the specific inputs and model used are plausible. PPLICA Statement No. 2S, p. 34.

The PPLICA capacity price forecast satisfies all three criteria. The PP&L capacity price forecast fails miserably in all three criteria in a manner that systematically understates the price of capacity and inflates the utility's stranded cost claim. PPLICA presents a reasonable and reliable projection of capacity prices in the competitive market. The PPLICA prices are based on reasonable inputs, a logical model, and resulting prices that support the addition of adequate new capacity. This is a stark contrast to the PP&L capacity price projections, which rely on inputs designed to understate capacity costs, are

based on a witness' judgments rather than a model, and produce results intended to increase PP&L's stranded costs.

The Commission endorsed the use of the capacity and energy market prices resulting from the OCA's application of the ENPRO model in the PECO proceeding. PECO Restructuring Order, slip op. at 89-90. Because of the need for consistency in the market prices used to determine stranded costs for all utilities in the PJM region, it would be appropriate for the Commission to use the OCA market price projections in this proceeding.

1. Methodology

a. Capacity Price Inputs

The first element to be examined in determining the adequacy of a capacity price forecast is the inputs to the forecast. Specifically, the inputs must be reasonable and independently derived. PPLICA witness Falkenberg relied on publicly available sources and made adjustments only when the data obtained from the source was clearly wrong or inappropriate for the model. PPLICA Statement No. 2, p. 59. PP&L, on the other hand, used data derived by its expert solely for use in this proceeding and made many ad hoc adjustments to the data. The ad hoc adjustments made by PP&L's Dr. Jones do not result in input values within the realm of reasonableness.

Two inputs are critical to the forecast of capacity prices: projected fuel prices and the cost and efficiency of new generating units. On both subjects, Dr. Jones' assumptions are unreasonable and clearly designed to depress his market price forecast and increase PP&L's stranded generation costs. Both inputs offered by PP&L must be rejected.

First and foremost, Dr. Jones' projected fuel prices must be wholly rejected. Instead of relying on an independent, nationally recognized fuel price forecast, PP&L requested Dr. Jones to manufacture his own forecast for use only in this proceeding. PP&L Statement No. 7, Direct Testimony of Scott T.

Jones, pp. 35-37 & 38-40. Fuel price is a key determinant in the calculation of market price (both capacity and energy), and, consequently, a key determinant in PP&L's stranded cost determination. PPLICA Statement 2, p. 29. For such a key variable, the Commission cannot rely on a forecast fabricated solely for this proceeding and structured to produce the sponsoring party's desired result — lower electricity prices and higher stranded costs.

The inflation rates contained in the Jones fuel price forecast underscore the forecast's lack of basis and validity. Dr. Jones boldly claims that his forecast represents a "consensus" view. PP&L Statement No. 7, p. 39. Dr. Jones' "consensus" is a consensus of one. Dr. Jones claims to have reviewed many independent forecasts in arriving at his forecast; however, instead of examining both low and high price scenarios from those forecasts, Dr. Jones based his "consensus" on the low price scenarios. PPLICA Statement 2, p. 31. Dr. Jones' "consensus" forecast conveniently predicts low fuel prices, which are, in turn, conveniently the exact input variable necessary to perform his next job for PP&L — a prediction of low future market prices. Id. Those low market prices conveniently result in high stranded cost recovery by PP&L. Id.

In addition, the comparative differences between price escalation for different types of fuel in the Jones forecast are engineered to increase PP&L's stranded cost recovery. Most of PP&L's generators are coal-fired. Id. at 34. The PJM marginal cost and market price, however, will frequently be determined by gas or oil prices. Id. Thus, PP&L's potential for profit growth will be influenced by the spread between coal prices and oil and gas prices. Id.; OCA Statement No. 2, p. 9. Because Dr. Jones' market price forecast is designed to depict a dire situation for PP&L in the competitive market (and to obtain excessive stranded cost compensation), Dr. Jones predictably includes a small spread between anticipated coal prices and oil and gas prices in order to indicate lower profit growth for PP&L.

Id. In comparison to other independent forecasts, such as EIA used by PPLICA, the Jones forecast portrays the least favorable set of circumstances for PP&L. Id.

Dr. Jones' forecast of a major input into the market price forecast is clearly biased. Both the Jones biased fuel price forecast and his resulting market price forecast must be rejected.

b. Model Used

The second criteria for evaluating a market price forecast is the model. Dr. Jones stated in testimony that he used the EGEAS model for his forecast. The unreasonableness of PP&L's inputs and the inappropriateness of the EGEAS model for predicting prices in a competitive market will be discussed in Section IV.C.1.a., infra. A discussion of the EGEAS model is unnecessary at this time because it is evident that Dr. Jones' capacity prices have only a tangential relationship to the capacity prices forecasted by the EGEAS run. Mr. Falkenberg appropriately used the Kennedy Production Cost Model ("KPC Model") for both capacity and energy prices.

Regardless of the inputs used by PP&L and invalidity of the EGEAS in predicting prices in the competitive market, it was revealed that Dr. Jones did not use the EGEAS model itself to predict capacity prices. PPLICA Statement No. 2S, pp. 14-16. Dr. Jones reviewed the capacity prices produced by the PP&L run of the EGEAS model; however, instead of relying on those figures, Dr. Jones "guesstimated" what the capacity price for electricity in a competitive market will be. Id. Instead of relying on the same model that PP&L used to forecast energy prices to make the other critical determination of projected capacity prices, Dr. Jones based his capacity price on a review of the EGEAS formulated capacity prices and on various prices for capacity that have been proposed during PP&L negotiations as a seller of capacity to potential buyers in the wholesale market. PPLICA Statement No. 2S, Exhibit No. RJF-10, p. 2. After the initial year (in which the capacity price was based on these negotiations) Dr. Jones arbitrarily decided to escalate that cost of capacity by 2% each year for the

remaining part of the forecast period. Id. at 3. Dr. Jones' forecast clearly fails the second criteria because it is based on no model — the forecast is based solely on Dr. Jones' judgment that the cost of capacity being discussed in wholesale negotiations (which may or may not have led to a contract) will remain valid (with a small fixed escalator) in a competitive environment in which many more entities will desire the capacity. The decision facing the Commission in this proceeding is simply too important for the Commission to rely on the uncorroborated judgment of one obviously biased.

Mr. Falkenberg, on the other hand, used the same production cost model to determine both the future capacity prices and the future energy prices that PP&L will face in the competitive market. PPLICA Statement No. 2, pp. 50-71. Even the PP&L witness hired to discredit Mr. Falkenberg stated that the model developed by his consulting firm predicts both capacity and energy prices and that the model contained a relationship between the two prices "embedded in the equations that are in the model." Tr., p. 1694, Aug. 26, 1997 (Jonathan S. Falk). Considering the dynamic relationship between energy and capacity prices, developing a total energy price forecast based on the energy and capacity prices produced by the same model is much more prudent than basing one component on the model and one component on a consultant's independent judgment. PPLICA Statement No. 2S, p. 12.

c. Reasonableness of Results

Furthermore, the comparison of the results reached by the two experts reveals the validity of the Falkenberg analysis and the invalidity of the Jones analysis. One of the most basic economic principles with respect to the addition of new capacity in a system is that the market price of capacity will determine when new units will be added to the system. When the market price is sufficient to recover the investment, a new unit will be built. PP&L's Mr. Falk admitted that his company's market price model produces prices sufficient to support the anticipated addition of new capacity "When I run it right." Tr., p. 1695, Aug. 26, 1997 (Jonathan S. Falk).

Mr. Falkenberg's market capacity prices are sufficient to support the addition of new capacity in the PJM region. On the other hand, Dr. Jones' "guesstimated" capacity prices simply make it uneconomic to build any new CT capacity in the PJM region. PPLICA Statement No. 2S, p. 17, Exhibit Nos. RJF-11A-R & RJF-11B-R. Pursuant to Dr. Jones' forecast and based on Dr. Jones' assumptions of market capacity and energy prices, any new CT capacity added would not cover its cost of investment. Id. The impact of this finding is heightened because, in PP&L's most recent run of the EGEAS model, the only type of capacity presumed to be added to the system until 2008 is a CT. Id. This inability of projected prices to sustain new capacity additions is a fundamental flaw in Dr. Jones' projections and makes his capacity prices too implausible to be relied upon by the Commission.

2. Cost And Efficiency Of New Units

A second key input determinant in the capacity price forecast is the cost and efficiency of new generating units. Dr. Jones includes many erroneous inputs with respect to the cost and efficiency of new capacity. All of these errors have the effect of understating price or overstating efficiency, thus driving down market price. These flaws are yet another reason why the Jones analysis must be rejected.

Dr. Jones assumes that a combined-cycle unit will cost \$595/kW. PP&L Statement No. 7, Exhibit STJ 5. PPLICA accepts this assumption. PPLICA Statement No. 2, p. 63. Dr. Jones projects a cost of \$338/kW for a gas-fired CT unit. Id. at 68. PPLICA, on the other hand, models the future market based on an oil-fired CT costing \$300/kW. Although PPLICA does not directly challenge the cost used for the gas-fired CT by PP&L (because PPLICA uses oil-fired CTs in its analysis), in establishing the gas CT cost Dr. Jones did not fully include the cost of the pipeline and other items. Id. at 69. In other words, the cost stated by Jones may not reflect the cost that builders of new capacity will incur. If the actual cost is higher than those projected by Dr. Jones, then market prices will need to rise to attract capacity additions. The motivation for Dr. Jones' underestimation is clear: as long as Dr.

Jones can understate the cost of new capacity, he can assure capacity additions necessary to fulfill anticipated load while maintaining the low market prices necessary to buttress PP&L's stranded cost claim.

Dr. Jones uses a cost of capital of 8.91%. This estimate is extremely optimistic, especially given the heightened risk that will be placed on developers of generation in the competitive market. PPLICA Statement No. 2, pp. 37-38. The use of this optimistic number directly depresses market capacity prices and enhances the attractiveness of new combined cycle capacity additions, which will in turn further depress prices. Id.

With respect to the efficiency of new units, PP&L uses extremely optimistic estimates. PP&L uses a 7,000 btu/kWh heat rate for new combined-cycle units, which is equal to or better than the most efficient currently operating plants. PP&L Statement No. 7, Exhibit STJ 5. See PPLICA Statement No. 2, p. 70. Once again, Dr. Jones includes unreasonable assumptions regarding efficiency of new construction to depress the price and induce hypothetical investors to build new capacity at the lower market prices he projects. Dr. Jones is thus able to keep supply and demand at equilibrium without substantially raising market prices.

Finally, Dr. Jones assumes that new units will experience a reliability substantially better than existing units. Id. at 63. This assumption may be unwarranted. First, there is a tradeoff between reliability and plant capital costs that would make PP&L's estimate of capital costs increase because of the assumed increase in reliability. Id. In other words, the low plant costs depicted in the PP&L analysis will not ensure the assumed level of reliability depicted in the analysis. In addition, the assumption may be contrary to practical experience because many serious problems are being experienced with advanced combined-cycle and CT units. Id. at 64.

Dr. Jones' assumptions with respect to the cost and efficiency of new capacity are additional examples of self-interested selection of inputs designed to obtain PP&L's desired result. The Jones market price analysis is riddled with such errors and must be rejected by the Commission.

C. PRICE OF ENERGY

1. Choice And Use Of Models

Three market price forecasts for energy prices were presented in this proceeding using three different models. PP&L presented a market price forecast based on the EGEAS model. PPLICA presented a market price forecast based on a model developed by J. Kennedy & Associates, Inc., a consulting firm located in Atlanta, Georgia ("KPC Model"). The OCA presented a market price forecast using the ENPRO dispatch simulation model.

The KPC Model is a correct and reliable forecast of the market prices for energy upon which the Commission can rely on this proceeding. First, the KPC Model is appropriate for predicting prices in the competitive market. EGEAS, on the other hand, is mired in assumptions that will not be valid in the competitive market. Second, the inputs and assumptions used by PP&L in running the EGEAS model are so riddled with errors so as to be completely unreliable as a basis for decision by this Commission. Whether by coincidence or by design, these errors each have the effect of depressing market price and increasing PP&L's stranded costs. With respect to at least one of these input errors, namely fuel prices, the totality of the circumstances evinces a deliberate attempt to tailor the input assumption in order to reach the result favorable to PP&L. PPLICA relies on publicly available sources for its input assumptions and only makes changes to that data in limited circumstances. In addition, adjustments made by the PPLICA witness are conservative and depress market price, in contradiction to any purported desire by PPLICA to increase market price and thereby decrease stranded costs.

The Commission must follow its decision in the PECO restructuring proceeding when setting market prices for PP&L. Both PP&L and PECO are members of PJM and will face similar (if not identical) market conditions in the future. PPLICA remains convinced that the KPC price analysis present in this proceeding and in the PECO restructuring proceeding is an appropriate and reasonable prediction of the future market prices in PJM. In recognition of the need for fairness and consistency in the Commission's treatment of the restructuring filings by the PJM member utilities, however, PPLICA is willing to accept use of the OCA's analysis for future PJM market prices in this proceeding.

a. Realism or Reliability of Output

A model is a series of mathematical relationships relating inputs and outputs. PPLICA Statement No. 2S, p. 34. In the instant situation, the models are being used to determine the market price of electricity in the deregulated market. As discussed in Section IV.B., supra, the Commission should consider three factors in its determination of whether to rely on the market prices forecasted by any model: (1) whether the inputs are reasonable and are independently derived; (2) whether the model structure is logical; and (3) whether the results obtained from the model are plausible. Id. The KPC market price model presented by PPLICA in this proceeding fulfills all three criteria and should be adopted for the projection of market prices. Conversely, the market price analysis presented by PP&L contains numerous errors both in inputs and in the application of the model and produces results that are not sustainable in a competitive environment. Not surprisingly, these errors skew the results of the forecast towards the desired result for PP&L — low market prices and resulting high stranded cost recovery. Consequently, the PP&L market price forecast must be rejected.

1. The Model

The KPC Model consists of two basic models that predict prices in a competitive bid-based market. First, the KPC Model contains a probabilistic market price simulation. Probabilistic models

compute the expected value of production costs (both total and marginal costs) by computing the probability weighted average of all possible generator outages. PPLICA Statement No. 2, p. 56. The KPC Model also contains a Monte Carlo pumped storage simulation. This simulation estimates the hourly marginal costs for a given region to determine whether a generator should use a pumped storage unit on a given day. Id. at 55. This hourly marginal cost data is then input in the probabilistic simulation to determine hourly market clearing prices. Because the Monte Carlo model contains a chronology of daily loads, it can be used to develop an input load shape for the probabilistic model and/or to develop chronological marginal costs for other purposes. Id. In this proceeding, PPLICA witness Falkenberg used the probabilistic model to compute the revenues and market prices for all units except for pumped storage units, which were analyzed according to the Monte Carlo model. Id. at 57.⁶

On behalf of PP&L, Dr. Scott Jones presented a market price analysis purportedly based on runs from the EGEAS model. PP&L Statement No. 7, Exhibits STJ 7 & STJ 8. The EGEAS model depicts a regulated cost-constrained energy market. PPLICA Statement No. 2, p. 15. This is fundamentally different from the KPC Model's simulation of a competitive market. Because the market prices adopted in this proceeding should reflect the anticipated competitive market instead of the discarded regulated market, the EGEAS model and the PP&L market price forecast based on that model must be rejected.

The EGEAS model predicts market prices based on assumptions that are only valid in a regulated market. For example, the EGEAS model improperly treats start-up and no-load costs. This flaw in the EGEAS model will be discussed in detail in Section IV.C.2.b., infra. In addition, Dr. Jones misapplied the EGEAS model. The most egregious error in PP&L's analysis, and one that completely invalidates the use of the Jones forecast for determining stranded costs, is the misguided assumption that

⁶For a further explanation of the KPC model, see PPLICA Statement No. 2, pp. 52-57.

swing units (intermediate and peaking units) will operate during uneconomic hours where the market price is not sufficient to recover the units' dispatch costs. Id. at 46-47. This obviously contradicts rational business behavior in a competitive market in which a unit will operate only when the market price is sufficient to recover all dispatch costs.

In determining revenues to be paid to generators, other flaws in application of the EGEAS model by Dr. Jones include the following:

- Dr. Jones systematically understates revenues received from intermediate and peaking units by assuming average baseload plant operation, while actual baseload plant operations reflect below average operations. (Id. at 43.)
- Dr. Jones greatly understates the number of hours that intermediate and peaking units will operate. (Id.)
- Dr. Jones applies a completely ad-hoc method for mapping hours when particular units are dispatched and the correlating expected value of market prices. (Id. at 48.)
- Dr. Jones establishes there is no real relationship between the expected value of market prices computed and the expected value of revenues paid to generators. (Id.)

Each error, individually and in the aggregate, results in a further depression of Dr. Jones' market prices.

These fundamental errors, as well as errors that will be discussed subsequently in the determination of the inputs used in the model, mandate that the Commission reject Dr. Jones' use of the EGEAS model and the resulting stranded cost calculations presented by PP&L. Id. at 47.

2. The Inputs

A crucial area that the Commission must examine before adopting a market price forecast in this proceeding is the reasonableness and independence of the inputs used by the modeler. An examination of the input data used by PP&L, as compared to the PPLICA inputs, evinces that PP&L tainted the analysis by using inputs designed to support the desired PP&L conclusion of low market prices and

resulting high stranded costs. Flaws in specific input assumptions are discussed below in Section IV.C.2. through 6., infra. In general, however, the validity and independence of all PP&L inputs must be questioned.

In determining the inputs that would go into the KPC Model, PPLICA witness Falkenberg obtained the majority of the data from publicly available sources. PPLICA Statement No. 2, p. 53. Mr. Falkenberg made adjustments to the data only where the original source was clearly wrong or inappropriate for use in a competitive model. Id. at 60.

Dr. Jones, on the other hand, makes extensive ad hoc adjustments to inputs based on his judgment. PPLICA Statement No. 2S, p. 34. Dr. Jones makes so many adjustments that it is difficult to determine whether he is really using the EGEAS model at all. Considering the magnitude of the decision before this Commission, it would be imprudent to rely upon a market price forecast so riddled with adjustments and "guesstimates" that it cannot be logically followed. As PPLICA explained:

In the face of uncertainty, intelligent assumptions and reasonable analysis are the best tools available to the decision maker. The less complicated, and more *transparent* these analyses are, the better and more useful they will be.

* * *

... Dr. Jones' judgmental approach is not transparent at all. There is literally no way that one can determine the connection between the inputs and outputs. Dr. Jones' "model" is truly a *black box* that he can assert consistently considers any and all variables. However, there is no way to determine the relevant significance of any single variable, or the logical connections between any two variables in Dr. Jones' mental modeling process.

Id. at 41 (emphasis original). Apart from Dr. Jones' testimony, PP&L has provided negligible evidentiary support for the inputs used in the market price forecast. On the whole, the Commission should be very reluctant to adopt a forecast of market prices based on the scant information provided

by PP&L, with respect to the inputs used and functioning of the “model” given the obvious potential for bias on the part of the witness in making judgmental inputs.

The most egregious example of the lack of evidentiary support for PP&L’s inputs is the anticipated fuel prices used by Dr. Jones in the EGEAS modeling. In addition to performing PP&L’s market price analysis, Dr. Jones developed the fuel price estimates that went into that analysis. PP&L Statement No. 7, pp. 38-39. The Commission should not adopt a market price analysis in which the same witness has prepared the fuel price estimates as is preparing the resulting electric market price forecast. PPLICA Statement No. 2, p. 29. All witnesses in this proceeding agree that projected fuel prices are an important determinant of forecasted market price. PP&L Statement No. 7, p. 35. Because of the importance of this particular input in the ultimate determination of stranded costs, the Commission should insist that fuel prices be independently derived by a separate source. Instead of manufacturing a biased fuel price forecast designed to achieve a desired result, PPLICA relies on a nationally known, independent source — the Energy Information Administration (“EIA”). PPLICA Statement No. 2, p. 29. Without having the fuel price forecast and the market price forecast prepared by independent witnesses, there is simply no way for the Commission to be assured that Dr. Jones’ desired market price result did not influence his projection of fuel prices. Id.

3. Reliability of Results

One of the key indicators of whether a model is producing reliable results is whether the market prices produced by the model will support the addition of new capacity. This is yet another factor where the Jones forecast falls drastically short. The market prices resulting from Dr. Jones’ model (energy and capacity) are insufficient to support the capacity additions predicted in the model. PPLICA Statement No. 2S, Exhibit Nos. RJF-11A-R & RJF-11B-R. Any new CT capacity added to the PJM system would operate at a loss each year. PPLICA Statement Nos. 2S, p. 15. Investors, however, will not build

generators in the competitive market unless those generators will be reasonably assured of operating at a profit. Id. Dr. Jones' EGEAS modeling predicts and relies on generating capacity additions that simply will not occur in the competitive market. This is fundamentally illogical and cannot be endorsed by the Commission. Mr. Falkenberg's market prices, on the other hand, will support the addition of new generating capacity and should be adopted by the Commission.

a. Treatment of Start-Up and No-Load Costs

One of the major conceptual differences between the KPC market price model and the EGEAS model as used by PP&L is the treatment of start-up and no-load costs. In short, the EGEAS model does not include no-load costs as part of its bid price and thus, the bid is only based on the incremental heat rates. PPLICA Statement No. 2, p. 21. The KPC Model bids units based on the average heat rate, which includes no-load costs as part of the bid price. Id. at 17. The bid price determines when particular units will operate to meet load requirements. It is this difference in the treatment of no-load costs that results in the KPC Model depicting a competitive market while the EGEAS model continues to depict a regulated market.

No-load costs are the costs that must be incurred before a unit is able to produce a single kW of electricity. In the traditional PJM format, which was categorized by a pool-wide integrated dispatch to meet reliability requirements and minimize total system costs, the "obligation to serve" customers would bear the no-load cost of those units because the units were already running to service their needs. PPLICA Statement No. 2, p. 16. After the no-load costs were recovered via the obligation to serve customers, additional sales by that unit were priced to recover the incremental costs of increasing or decreasing the unit's output. Id.

The movement to a competitive market will necessarily change the treatment of no-load costs in hourly price bids by generating units. The objective in a competitive market will be to maximize the

producers' profits, not to minimize the pool-wide energy costs. Id. at 17. In addition, the generator will have no captive customers from which to recover the no-load costs because there will no longer be any "obligation to serve" customers. Id. Consequently, the generator must recover the no-load costs within the bidding process. Generator bids will still be based on the incremental costs to produce electricity; however, the incremental costs will be redefined to include no-load costs as a component. Id. at 18. Thus, bidding in the competitive market will reflect the average heat rate cycling of a unit, not the lower incremental cost to increase or decrease the unit's output. Id. at 17. If the projected market price in a given hour is not sufficient to recover all of the variable costs of running the unit (including no-load costs), then the rational generator will not run that unit in that hour. Id. at 23. Even if the unit is already running, in many circumstances it would be wiser to stop the unit if the market price for the next hour is less than the average heat rate bid.⁷ Id.

Although Dr. Jones acknowledges that bidding based on the traditionally defined incremental costs will not recover all costs experienced by generators in the competitive market and that bidders will "account for this factor in their bid for production of blocks of energy," he makes no adjustments to the EGEAS model to reflect the bidders' actions in this regard. Id. at 24-25. As a result, Dr. Jones has systematically assumed that generators will bid below actual variable costs and operate many hours at a loss because of this irrational bidding behavior. Id. at 24 (quoting PP&L Docket No. R-00973954, Response to OCA Data Request Set III., Q45, part b). This represents a fundamental flaw in the EGEAS

⁷In some cases (e.g., units that will take a long period to restart) the generator may continue to participate in the market and to bid at a lower than average heat rate. PPLICA Statement No. 2, p. 26. The KPC Model deals with this situation by modeling those units on the average full load heat rate. Id. at 27.

modeling and substantially understates the future price of electricity.⁸ Id. The EGEAS model is inappropriate for use in this proceeding because of this flawed treatment of no-load costs.

4. Fuel Prices

All experts in this proceeding agree that fuel prices are an extremely important component of the market price determination. PPLICA used an independent, well recognized, unbiased long-term fuel price forecast issued by the Energy Information Administration ("EIA") in determining its market price forecast. PPLICA Statement No. 2, p. 58. PP&L, on the other hand, employed Dr. Jones to perform his own fuel price forecast and then to use that forecast in making his market price projection. PP&L Statement No. 7, pp. 38-40. At least three factors mandate that the Commission reject both the obviously biased Jones fuel price forecast and the resulting PP&L market price forecast.

First, in making the determination of such a crucial component of the market price projection, this Commission should rely on recognized forecasts prepared by independent organizations. PPLICA Statement No. 2, p. 29. Every other party in this proceeding that presented a market price forecast recognized the clear need to rely on an independent fuel price forecast.⁹ It is much more prudent for the Commission to rely on a forecast prepared by an organization that has no stake in this proceeding and will not be directly effected by the market price and stranded cost determinations made in this proceeding. It is wholly inappropriate for the Commission to rely on a fuel price forecast prepared (and

⁸Mr. Falkenberg provided a concrete example of the differences in market prices caused by bidding on average heat rate instead of incremental heat rate. The Martins Creek 4 unit has an average heat rate of 11,600 btu/kWh at a minimum load and an incremental heat rate of 9,000 btu/kWh at a minimum load. Dr. Jones, using the EGEAS model, would bid this unit at the 9,000 incremental rate, which, assuming a gas price at \$2.00/MMBtu, would produce an electricity price of \$18.00/mwh. However, if the same unit was modeled using the 11,600 average heat rate, at the same gas price, the electricity bid price for the generator to break even and cover all costs would be \$23.20/mwh. PPLICA Statement No. 2, p. 21.

⁹The OCA relied on the DRI forecast. OCA Statement No. 2, p. 22.

paid for) by an interested party in this proceeding and intended to be used solely for the critical determination of this proceeding. This is especially true where, as here, that forecast is based on little evidentiary support other than the judgment of a paid consultant and where, as here, that forecast conveniently produces the results most advantageous to the Company.

Second, PP&L compounds the problem of not using an independent fuel price forecast by using the same witness to prepare its fuel price projection as it uses to prepare the electric market price forecast. Id. Fuel prices are a major component of expected market prices, which in turn dictate the amount of stranded costs PP&L will be allowed to recover. PP&L places before the Commission a stranded cost calculation in which the key determinant of the calculation is based on the witnesses' judgment. There is simply no way to determine whether cognizance of the desired market price necessary to produce PP&L's desired level of stranded costs influenced Dr. Jones' projection of fuel prices. Id. The Commission cannot reasonably rely on either of the Jones forecasts when the complete independence of those forecasts cannot be established.

Third, the various components of Dr. Jones' fuel price forecast are unreasonable and evidence a desire to tailor the forecast to achieve the desired market price result. Dr. Jones projects that gas and oil prices will remain flat (in nominal terms) until 2000 and then will escalate with inflation. Id. at 30. However, if Dr. Jones had chosen a longer period of flat prices, the resulting market price forecast would have produced "markedly different results." Id. These markedly different results would increase market price and decrease PP&L's stranded costs. In addition, Dr. Jones' projected spread between coal prices and oil and gas prices depicts the best situation for PP&L in this proceeding; i.e., the result that depresses market price and increases stranded cost recovery. In the PJM pool region, the marginal cost is frequently determined by oil and gas fired units and, consequently, by the oil and gas prices. Id. at 34. Most of PP&L's generators, however, are coal-fired. Id. A fuel price forecast that contained a

wider spread between the oil/gas prices and coal prices would result in a forecast of larger profit growth for PP&L. Id. Of the three forecasts presented in this case, the Jones forecast predicts the smallest spread between these prices. Id. at 13, Exhibit RJF-2.¹⁰ Based solely on this input, Dr. Jones predicts lower profits for PP&L and higher stranded costs.

PPLICA used the EIA forecast, which represents a conservative estimate of the spread between coal prices and gas and oil prices. Id. Although other forecasts depicted a larger spread, PPLICA relied on a reasonable estimate of the spread that actually increases PPLICA's calculation of PP&L's stranded costs. Id. Because Mr. Falkenberg was interested in obtaining an accurate and reliable calculation of market prices in the competitive market, he did not use his "judgment" to adjust the EIA forecast to benefit his clients.

5. Inflation

Three different estimates of the general rate of inflation were used as inputs to the various models. PPLICA and the OCA used the percentage increase in inflation that corresponded to the inflation rates in the respective commercial forecasts of fuel prices relied upon by each party. Dr. Jones, on the other hand, used his independent judgment to determine his rate of general inflation.

Dr. Jones used a 2.5% input for general inflation. PP&L Statement No. 7, Exhibit STJ 5. This was another variable that Dr. Jones used his judgment to guesstimate. PPLICA and the OCA used 3.3% (EIA forecast) and 3.4% (DRI forecast), respectively. See PPLICA Statement No. 2, Exhibit No. RJF-2. The consistency between the PPLICA and OCA inflation numbers and the acceptance by the Commission in the PECO proceeding of the OCA stranded cost calculation based on the DRI forecast evinces the reasonableness of using an inflation input of 3.3% or 3.4%.

¹⁰The Jones spread between oil/gas prices and coal prices is 0.8%, the DRI spread is 3%, and the EIA spread is 1.4%. PPLICA Statement No. 2, p. 34.

In addition, because a low rate of general inflation depresses market price and increases PP&L's stranded costs, Dr. Jones has again conveniently chosen an input value designed to fulfill PP&L's desired result. PPLICA Statement No. 2, p. 32. Again, instead of making an ad hoc adjustment to the independent fuel price forecast, Mr. Falkenberg used the general inflation rate predicted by EIA. The Commission should reject Dr. Jones' self-interested selection, and instead endorse the PPLICA general inflation input of 3.3%.

6. Load Growth.

PPLICA is not addressing load growth, but may respond in its reply brief.

7. Efficiency Of New Capacity

The efficiency of new capacity is indicated by the expected heat rate of the unit. The lower the expected heat rate, the more efficient the unit and the lower the cost to produce energy. The anticipated costs of operating new units are an important factor in a market price forecast because the cost of producing electricity determines when units will operate in the competitive environment. See PPLICA Statement No. 2, pp. 15-27. A generator will only offer electricity for sale when the market price is sufficient to recover the costs of producing electricity.

Dr. Jones anticipates that new combined-cycle units will have an average heat rate of 7,000 btu/kWh. Id. at 27 & 70. Although PPLICA believes that this figure is within the realm of possibility, the Jones heat rate assumption is extremely optimistic; it equals or betters the most efficient units in use today. Id. In addition, use of this anticipated heat rate may be unreasonable given the plethora of problems being experienced with the advanced combined-cycle and combustion turbine technology currently in use. Id. The use of this optimistic heat rate and the correlating underestimation of the cost of operating new units further depresses the Jones projected market prices.

8. Other Inputs

* * *

PPLICA is not addressing the following items in Section IV.C.8 — Other Inputs: Nuclear Capacity Factor; Variable O&M; Environmental Costs; NUG Output; and, Ancillary Services. PPLICA may respond to these items as appropriate in its reply brief.

* * *

c. Reserve Requirements

PPLICA and PP&L employ the same reserve requirement of 18%. PPLICA Statement No. 2S, p. 13; PP&L Statement No. 7, p. 24.

e. Inclusion of A&G

PP&L has not included any portion of A&G in its market price determination. PPLICA Statement No. 2S, p. 60. The only apparent basis for the exclusion of A&G is the belief that PP&L's current staff level will be sufficient to maintain and operate any additional units. This assumption is clearly unreasonable; it is illogical to assume that PP&L will not need to hire additional staff with respect to additional units.¹¹ Id. By excluding A&G, PP&L has again predicted that the costs of producing electricity will be less than the true costs.

Moreover, Dr. Jones' claims regarding the sufficiency of current staffing for new units in determining the market price is not consistent with the Company's treatment of A&G costs in the stranded cost calculation. PP&L includes all A&G currently incurred by the Company in the O&M component of the stranded cost calculation. Id. at 61. In other words, PP&L assumes that all of its staff

¹¹For example, as explained by Mr. Falkenberg, even if a new plant operated with no staff on site, PP&L would still have additional work in departments such as accounting that will eventually necessitate the hiring of additional staff. PPLICA Statement No.2S, p. 60.

will spend 100% of their time tending to existing plants and no time on new plants -- obviously an absurd result.

h. Other Inputs and Factors Affecting Price

Dr. Jones includes other flawed inputs in his EGEAS modeling that depress market prices, including the following:

- The retirement dates used by PP&L are unreasonable. Under the more accurate market price forecast used by Mr. Falkenberg, PP&L should extend the lives of some of its facilities. This would lead to more revenue being collected for these facilities to offset any stranded costs. However, PPLICA has reluctantly accepted those dates except for the Mine-Mouth plant and the PP&L CTs, for which PPLICA appropriately used life extensions as estimated by PECO in its restructuring proceeding. PPLICA Statement No. 2, p. 60.
- PP&L inappropriately included an allocation of general plant (e.g. office buildings) as part of stranded generation. This must be rejected because there is no evidence that these items will decrease in value in the competitive market (i.e., the assets are not "stranded") and because this expense will be faced by PP&L and potential competitors alike. Id. at 51-52.
- PP&L fails to reflect either the energy benefits or the investment related to the Company's 139 MW entitlement in the Safe Harbor hydroelectric plant. Id. at 52. PPLICA does include both benefits and investment related to Safe Harbor. Inclusion of the benefits of Safe Harbor decreases PP&L's stranded costs.

The presence of these flaws further supports the necessity of discarding the PP&L market price forecast and quantification of stranded costs.

D. CONCLUSION

The PP&L market price forecast contains fundamental errors that completely invalidate its use in this proceeding. First, the EGEAS model employed by PP&L is not suited for modeling a competitive market. The model inappropriately treats no-load costs in the same manner those costs were treated in the regulated environment, and consequently, inappropriately fails to recover all costs of generating before predicting that a plant will operate. Second, Dr. Jones misapplies the EGEAS model in some

instances (i.e., the treatment of intermediate and peaking generators) and fails to apply the model at all in others (i.e., his prediction of capacity prices). Third, Dr. Jones bases his forecast on inputs that are clearly unreasonable. The most egregious incidence is the Jones fuel price assumptions, which are obviously biased toward achieving the desired market price result. On the whole Dr. Jones made countless errors based on his "guesstimates" that conveniently slanted his forecast towards lower future market prices. As PP&L witness Falk stated: "Garbage in, garbage out." PP&L Statement No. 20R, Rebuttal Testimony of Jonathan S. Falk, p. 7. Dr. Jones placed biased input assumptions into the EGEAS model, and obtained a biased market price forecast from the model. The Commission cannot accept his results.

PPLICA presented a reasonable and accurate market price forecast performed by Mr. Falkenberg. Unlike Dr. Jones, Mr. Falkenberg used a model designed to predict prices in a competitive electricity market instead of a regulated market. Mr. Falkenberg used publicly available sources for his input data and made adjustments only when the data was clearly wrong or inappropriate for use in a competitive market model. Finally, unlike Dr. Jones, Mr. Falkenberg predicts market prices that will be sufficient to support the addition of new capacity in the PJM region. The PPLICA market price forecast should be accepted by the Commission. Alternatively, the Commission should acknowledge the need for fairness and consistency in its decisions regarding the PJM member utilities' restructuring proceedings by using the OCA forecast in this proceeding as it did in the PECO proceeding.

V. REVENUE UNDER REGULATION

A. PUC JURISDICTIONAL ALLOCATION

PPLICA's stranded cost calculation incorporates PP&L's proposed jurisdictional allocation.

B. COST OF CAPITAL

Although not specifically endorsing the validity thereof, PPLICA's stranded cost calculations used the cost of capital for both equity and debt as calculated and proposed by PP&L.

C. REGULATORY ASSETS AND LIABILITIES

PP&L claims stranded regulatory assets in the amount of \$354.326 million in this proceeding. PP&L Statement No. 8, Direct Testimony of Joseph R. Schadt, Exhibit JRS 1A (Revised), p. 1. In recognition of the netting concept, the known and measurable standard, and the requirement that all stranded regulatory assets be those that were typically recoverable in a regulatory environment discussed previously in Section II, supra, PPLICA adjusts PP&L's claim downward to a regulatory liability of \$55.588 million (NPV at 12/31/98). PPLICA Statement No. 3, p. 5; PPLICA Statement No. 3S, p. 19; See Appendix B & C, infra. This regulatory liability represents an amount that would be credited against otherwise qualifying categories of stranded costs before permitting recovery of those costs from ratepayers in the CTC. PPLICA's responses and adjustments to specific regulatory asset claims follow.

1. Unrecovered Energy Costs

PP&L claims as a regulatory asset to be included in the stranded cost calculation \$76.815 million in unrecovered energy costs. PP&L Statement No. 8, Exhibit JRS 1A (Revised); PP&L Statement No. 8, p. 21. This claim has two distinct parts: (1) actual unrecovered energy costs at December 31, 1996, of \$17.2 million; and (2) an estimated \$31.2 million in annual unrecovered energy costs for 1997 and 1998 that Company claims will be under-collected. Id.; PP&L Statement No. 3R, Rebuttal Testimony of Joseph M. Kleha, Exhibit JMK 5. Although PPLICA supports the recovery of actual unrecovered energy costs at December 31, 1996, PP&L incorrectly calculates the amount of unrecovered energy costs as of that date. In addition, the Company provides no statutory basis for its claim of future under-collected energy costs. Moreover, the Company has not properly supported its \$31.2 million annual

calculation of that claim. PPLICA Statement No. 3, p. 17. The claim for 1997 and 1998 under recovered energy costs must be rejected on both bases. Because the burden of proof is on the Company to establish the amount of the estimated under-collection, and because this burden has not been met, the Commission should not allow PP&L to recover in its stranded cost claim any estimated under-recovered energy costs for the years 1997 and 1998.

The Company miscalculated its actual unrecovered energy costs as of December 31, 1996. The correct calculation is \$16.2 million. PPLICA Statement No. 3S, Surrebuttal Testimony of Lane Kollen, p. 19. Only \$16.2 million should be included in the stranded cost calculation as a regulatory asset. Id.

The Company has completely failed to establish the legal basis and factual basis for the claim of anticipated 1997 and 1998 under-recovered energy costs. There is no support in the Act for the claim. The Act permits the utility to roll its energy cost rate (net under recovered energy costs) into base rates. 66 Pa. C.S. § 2804(4)(r). The unrecovered portion of this roll-in is reflected by PP&L's \$16.2 million claim. PP&L essentially seeks to roll the estimated under-collections of the 1997 and 1998 ECRs into the base rates by recovering the levels as regulatory assets. As recognized in the PECO proceeding, granting stranded cost recovery for fuel costs after the ECR roll-in circumvents the rate cap. PECO Restructuring Reconsideration Order, slip op. at 11.

In addition, future under-recovered fuel costs do not fulfill the statutory requirement for recovery in this proceeding as a regulatory asset. Section 2803 requires that all stranded costs, including those associated with regulatory assets, be "known and measurable." 66 Pa. C.S. § 2803. PP&L bases its claim for \$31.5 million in annual 1997 and 1998 estimated under-recovered energy costs on a five year average of historical fuel costs compared to the amount of ECR costs rolled into its base rates as of December 31, 1996. PPLICA Statement No. 3, p. 17. As recognized by the Commission with respect to an identical claim by PECO in its restructuring proceeding: "At this point in time, there is no 'known

and measurable' fuel cost since the expenses have not been incurred." PECO Restructuring Order, slip op. at 71. Future under-recovered fuel costs are not properly claimable as a regulatory asset because the costs are not known and measurable. 66 Pa. C.S. § 2803.

Furthermore, the five year average used by PP&L is not an appropriate basis upon which to estimate these costs. PPLICA Statement No. 3, p. 19. The Commission's final resolution of PP&L's ECR roll-in proceeding placed upon the Company the burden to establish in the restructuring proceeding the prudence, accuracy, and propriety of these under-collections. See Petition for Amendment of the Pennsylvania Power & Light Company Industrial Customer Alliance, Docket No. P-00961131, Opinion and Order entered on May 22, 1997. Relying on the five year average is not an appropriate way for PP&L to meet the burden. The methodology used by PP&L does not comport with the manner in which the ECR under-collections would have been computed in 1997 and 1998 absent the passage of the Act. PPLICA Statement No. 3, p. 19. Under traditional ratemaking, the Commission would not allow recovery of future anticipated fuel costs. Consequently, recovery for future under-recovered energy costs is not authorized under the Act. PECO Restructuring Order, slip op. at 71. Under traditional ratemaking, PP&L would have to study and reconcile the actual or estimated under-recoveries for 1997 and 1998 to request an increase in the ECR during those years. Id. Because PP&L has not (and cannot) fulfill this burden, the costs do not qualify as being "traditionally... recoverable under a regulated environment." 66 Pa. C.S. § 2803.

A comparison of the Company's assumptions in deriving the five year average to the 1996 actual results for the same inputs further highlights the unreasonableness of the PP&L proposal. The following assumptions used by the Company resulted in higher ECR costs and higher "unrecovered" fuel costs:

- Decline in projected fuel costs from PP&L generation;
- Increase in purchased power costs per kWh;

- Decrease in off system sales revenue;
- Decrease in off system sales volume; and,
- Decrease in line losses.

PPLICA Statement No. 3, p. 21. Use of these flawed assumptions to arrive at the 1997 and 1998 annual under-collections of \$31.5 million simply makes the Company's calculation too unreasonable to be relied upon by the Commission in executing its duty to ensure just and reasonable rates. PP&L has not shown that this figure represents the known and measurable amount of expected under-collection.

Because PP&L's claim for recovery of projected 1997 and 1998 under-recovered fuel costs as a regulatory asset is devoid of both statutory and factual basis, recovery must be denied.

2. Employee Transition Costs And Pension Plan

a. Employee Transition Costs

PP&L proposes to include a regulatory asset for employee transition costs of \$17.106 million. PP&L Statement No. 8, pp. 25-26 & Exhibit JRS 1A (Revised). This figure is based on the estimated severance and incremental pension costs for the years 1997 through 2001, amortized over five years and discounted to December 31, 1998. PPLICA Statement No. 3, p. 22.

The Commission cannot allow recovery for this claim. First, the costs for which PP&L seeks recovery are highly speculative. Id. PP&L provided no specific plans for reductions in personnel over the years in question upon which the Commission could base an estimate of severance and incremental pension costs and verify the reasonableness of the PP&L claim. Id. Consequently, the claim to recover employee transition costs as a regulatory asset does not satisfy the "known and measurable" standard for recovery of a stranded cost through the CTC. 66 Pa. C.S. § 2803. Second, the calculation performed by PP&L fails to account for normal employee attrition that would occur in those years. PPLICA Statement No. 3, p. 23. Because PP&L would experience a level of employee attrition regardless of the

transition to the competitive market, the claimed employee transition costs have not been "stranded" due to the transition and should not be recoverable as a regulatory asset. 66 Pa. C.S. § 2803.

If the Commission decides that the employee transition costs should be properly recoverable as a regulatory asset (which it should not because of PP&L's inability to support the incursion of measurable costs caused by the transition to the competitive market), then the amount of recovery proposed by PP&L is substantially overstated. Employee transition costs (if they are to be included at all) must be included as a regulatory asset on a future cash outlay basis. PPLICA Statement No.3, p. 23. Including employee transition costs on a future cash outlay basis will result in substantially less cost being recovered by the Company as a regulatory asset because of accounting recognitions of future pension and other post-retirement benefits expense. Id. The net present value of the future cash outlays for employee transition costs equal \$5.502 million at December 31, 1998. Id. In the event that the Commission allows recovery of a regulatory asset for employee transition costs, the proper quantification is \$5.502 million. Id.

b. Pension Plan Over Funding

The quantification of PP&L's stranded cost claim should recognize a regulatory liability for pension plan over funding. Through past base rates, ratepayers have been contributing to the PP&L pension fund to offset future anticipated liabilities PP&L would face in the regulated environment. PPLICA Statement No. 3, p. 14. The amount of pension costs included in base rates has lead to a substantial over funding of PP&L's pension fund assets. Id. In addition, ratepayers will continue to overcompensate PP&L for its pension fund expenses. Id.¹² As the Commission recognized in PECO:

¹²As of December 31, 1996, the fair value of pension assets was equal to \$1,187.224 million. However, the accumulated benefit obligation as of the same date was \$694.986 million, with a projected benefit obligation of \$886.704 million. PPLICA Statement No. 3, p. 14.

If these overcollections and related earnings are not credited to ratepayers now, they will escape any true-up or reconciliation which would have occurred under traditional cost-based regulation. Customers would never be recompensed. We must create an offsetting regulatory liability to be paid to ratepayers.

PECO Restructuring Order, slip op. at 76. PP&L should not be permitted to retain this overfunded amount in the competitive market. Equity and fairness require that the amounts the ratepayer pre-paid to help PP&L fund its pensions must be refunded to ratepayers.

In order to ensure that the transition to the competitive market is effectuated in a way that is fair to all participants, including ratepayers, the ratepayers should be entitled to a full credit and stranded cost quantification for these overpayments into PP&L's pension plan. 66 Pa. C.S. § 2802(7). PPLICA calculates that the appropriate regulatory liability for recognition by PP&L is \$253.832 million at December 31, 1998.¹³ PPLICA Statement No. 3, p. 14.

3. Taxes Other Than Income

PPLICA is not addressing this issue but may respond, as appropriate, in a reply brief.

4. Fossil Plant Decommissioning

PP&L included the projected costs of decommissioning fossil generation units as part of its generation stranded cost claim. PP&L Statement No. 8, p. 17. These costs are added to the projected plant costs in the last year of the particular plant's life and the two subsequent years. Id. PPLICA

¹³As explained in the testimony of PPLICA witness Lane Kollen, this estimate is conservative because it does not reflect past amounts collected from ratepayers (and amounts that PP&L will continue to collect for pension expense through base rates) that have not and will not be deposited into the pension fund. Since 1989, PP&L has retained all pension ratemaking collections for its own benefit and has not deposited those sums into the trust fund. These prepayments will never benefit ratepayers, even if the traditional regulatory system was continued. PPLICA Statement No. 3, p. 16.

calculates the net present value of those costs as \$315.867 million. See Id.¹⁴ This claim should not be allowed because it is contrary to the precedent established by the Pennsylvania appellate courts and the PUC; i.e., the claim for prospective fossil plant decommissioning was not recoverable under traditional regulation. In other words, the cost is not properly claimable as a stranded cost because it is not typically recoverable in the regulated environment. 66 Pa. C.S. § 2803. In addition, because the cost of decommissioning cost is speculative at this point, the claim violates the requirement that any stranded generation costs be “known and measurable.” Id.

Commission allowance of PP&L’s claim for fossil decommissioning cost would be contrary to the long established precedent of the Pennsylvania appellate courts and the PUC that such costs are not recoverable until they have been actually incurred. See Penn Sheraton Hotel v. Pennsylvania Public Utility Commission, 198 Pa. Super. 618 (1962); 1995 PP&L Base Rate Order, slip op. at 98-106, 1995 Pa. at LEXIS 189 at *141-154. In addition, the Commission denied recovery by PECO for future fossil decommissioning costs in its restructuring proceeding. PECO Restructuring Order, slip op. at 91-92.

In Penn Sheraton, the Superior Court held that a prospective loss in excess of the salvage value of the property that a utility may incur upon the retirement of that property in order to remove the property was not properly recoverable in a utility’s rate base. Penn Sheraton, 198 Pa. Superior at 623. The utility wanted to consider prospective negative salvage as an addition to its accrued depreciation for ratemaking purposes. Id. at 624. The court held, however, that the uncertainty associated with prospective negative salvage and the fact that the cost had not been incurred at the time prevented the consideration of prospective negative salvage in determining measures of actual value or actual depreciation. Id. at 625-26. The court stated:

¹⁴This calculation was performed using the PP&L methodology for NPV and revenue requirements. The supporting information is attached as Appendix G, infra.

Negative salvage attributed to existing plant is purely prospective; it is a cost which has not yet been incurred; it is uncertain when and if it will be incurred; and it is not a part of the original cost of construction of the facilities when first devoted to public service. To permit the recovery of prospective negative salvage is to permit the recovery of a total amount in excess of the original cost of construction prior to the actual expenditure of those costs and, in our opinion, represents the recovery of something in the nature of a future reproduction cost. The established law in this Commonwealth does not permit the recovery by annual depreciation of any such prospective excess.

Id. at 627. The court specifically distinguished prospective negative salvage from a situation where the negative salvage is incurred associated with the actual retirement of the property, which would constitute circumstances when negative salvage could properly be considered in a rate proceeding. Id. at 627-28.

The Commission has consistently adhered to this precedent with respect to fossil plant decommissioning. See 1995 PP&L Base Rate Order, slip op. at 98-106, 1995 Pa. PUC LEXIS 189 at *141-154; Pennsylvania Pub. Util. Comm'n v. West Penn Power Co., Docket No. R-80021082, Opinion and Order entered on Jan. 30, 1981, 54 Pa. P.U.C. 602, 629 (1981).

Furthermore, the Commission has rejected recovery for prospective fossil decommissioning as a stranded cost pursuant to Chapter 28. As the Commission stated in the PECO decision:

Prospective fossil decommissioning expenses are not recoverable under traditional ratemaking or as a stranded cost, because they are not "known and measurable" without a specific plan to decommission a particular plant at a particular time and in a particular manner. At this point in time, the record contains no evidence that any particular existing fossil plant will in fact have to be decommissioned at all, when such decommissioning might occur, the extent of decommissioning that will be required, the future use of the plant and its site, or the cost of the decommissioning found to be needed. At this point in time, no one knows whether a generation plant will require total dismantling to "greenfield" status or some other less expensive level of dismantling. Depending on the future use, existing plants connected to the transmission system and their sites may have a significant residual "salvage" value, partly offsetting, or even surpassing any cost of decommissioning.

PECO Restructuring Order, slip op. at 92. The completely speculative nature of a claim for future fossil decommissioning mandates rejection of both the PECO and the PP&L claims for stranded cost recovery.

The fossil decommissioning studies submitted by PP&L in this proceeding to support its claim are as speculative as the ones rejected by the Commission in the aforementioned cases. As explained by PPLICA witness Kollen, the studies are based on "assumptions premised upon assumptions." PPLICA Statement No. 3, p. 30. Some of these assumptions on their face support the assertion that PP&L has not and cannot satisfy the requirement under Chapter 28 that stranded costs be known and measurable. 66 Pa. C.S. § 2803.

- First, PP&L is requesting that the Commission rely on the assumption that the plants contained in the study will actually be permanently retired, dismantled, and the sites restored while they are under the ownership of PP&L without providing any evidence to insure that this will actually occur. PPLICA Statement No. 3, p. 30. Certainly, the utility should not be compensated for a prospective "expense" that it may be able to avoid if it divests itself of the plants.
- Second, PP&L is forcing the Commission to rely on the assumption that the facilities will be retired on the dates listed in the study. Id. at 31. Although the Commission has relied upon similar retirement date assumptions in nuclear decommissioning studies, nuclear plants are granted a license with an expiration date that can be used to establish a retirement date for the study. Tr., p. 1487, Aug. 25, 1997 (Lane Kollen). However, there is no similar license upon which to base the expiration date for fossil fuel plants.¹⁵
- Third, the projection of the cost to dismantle the fossil units is purely speculative at this point in time. PPLICA Statement No. 3, p. 31. The cost to dismantle the units will be a function of the technology available at the time and the cost of that technology, both of which are unknowable at this point in time. Id. The Commission cannot state with confidence that the requested fossil decommissioning costs are measurable. Id.

Moreover, PP&L treats fossil decommissioning costs inconsistently in its filing. PP&L wants recovery of these costs as stranded. In its stranded generation cost calculation, however, the Company does not include the prepayment of a similar obligation in determining the market revenues sufficient

¹⁵In addition, PECO and PP&L have used different retirement dates for the Keystone 1 and 2 units and the Conemaugh 1 and 2 units, with PP&L retiring said units at an earlier date. PPLICA Statement No. 3, p. 31.

to support the incremental cost of new generation capacity. PPLICA Statement No. 3S, p. 31. Thus, Commission approval of this recovery by PP&L would create an inconsistent treatment of these costs.

The PP&L claim for fossil plant decommissioning must be rejected. These costs were not typically recoverable under Commission precedent. Thus, the costs are not properly claimable under the Act. 66 Pa. C.S. § 2803; PECO Restructuring Order, slip op. at 91-92. In addition, the studies purportedly supporting the quantification are flawed and do not meet the known and measurable requirement for recovery under the Act. Id.

5. Nuclear Plant Decommissioning

PP&L estimates the costs of decommissioning its nuclear plants to be approximately \$9.5 million per year. PP&L Statement No. 3, pp. 12-15. The Company includes these costs as two portions of its restructuring filing. First, the Company includes the net present value of after tax future annual nuclear decommissioning expense accruals as a part of the market value and stranded generation cost associated with those plants. This inclusion decreases the market value of the plants and, thus, increases stranded costs associated with the plants. PPLICA Statement No. 3, p. 39. Second, the Company proposes to collect the accruals as a "wires charge" associated with transmission and distribution. Tr., p. 1134, Aug. 20, 1997 (Joseph M. Kleha). This bifurcated treatment could result in a double counting of these costs if the costs are collected through the wires charge but also continue to be included in the stranded cost figure. Id.

PPLICA asserts that the appropriate treatment of nuclear decommissioning accruals is to include such accruals in the market value and stranded generation calculation associated with the plants. PPLICA Statement No. 3, p. 38. These costs were included in Mr. Falkenberg's stranded generation cost calculation. PPLICA Statement No. 2, p. 71. PPLICA's stranded cost and CTC calculation have reflected all related expenses as being recovered through the CTC during the transition period. PPLICA

Statement No. 1, p. 55. PP&L proposes to collect the expense accruals over the life of the units via a mechanism apart from its CTC. In other words, PP&L will break its nuclear decommissioning costs out of its total stranded request claim authorized by the Commission in this proceeding.¹⁶ PP&L Statement No. 3, pp. 12-15. In the event that the Commission accepts PP&L's proposal and decides such costs should be recovered through a T&D wires charge, the PPLICA market value for PP&L's generating units must increase and PPLICA stranded cost calculation must decrease by the appropriate amount. PPLICA Statement No. 3, p. 39. PP&L acknowledges the necessity of ensuring the costs are only recovered via one mechanism or the other. Tr., pp. 1133-34, Aug. 20, 1997 (Joseph M. Kleha).

In addition to the extension of the recovery period for nuclear decommissioning costs, PP&L proposes to collect the further accruals after the seven-year transition period through a kWh charge. PPLICA Statement No. 1, p. 55. The PP&L proposal violates the Act's mandate that costs to be recovered must be allocated consistently with the last base rate proceeding. 66 Pa. C.S. § 2808(a). Nuclear decommissioning costs were allocated to rate classes on a demand basis in PP&L's most recent base rate case. PPLICA Statement No. 1, p. 56. Any recovery allowed beyond the transition period must be allocated based on a demand allocation factor and not the energy allocation proposed by PP&L. Id. To change the allocation methodology for recovery of nuclear decommissioning expenses will also violate the Act's mandate that stranded costs be collected in a manner that does not affect an inter- or intra- class cost shift. 66 Pa. C.S. § 2808(a). The nuclear decommissioning costs must be included in the stranded cost calculation on a demand-based allocation and not recovered as a wires charge.

¹⁶The Commission must be cognizant of the need to perform this breakout in determining the stranded costs to be recovered through the CTC in order to prevent double counting. Tr., p. 1134.

6. DOE Assessments

PP&L has requested recovery as a regulatory asset of a Department of Energy ("DOE") assessment of \$16.361 million. PP&L Statement No. 8, p. 24, Exhibit JRS 1A (Revised). This assessment represents PP&L's obligation to provide funds pursuant to the 1992 Energy Policy Act in the future for the decontamination and decommissioning of the DOE's uranium enrichment facilities. PPLICA Statement No. 3, p. 24. PP&L has included the identical costs in its stranded generation cost quantification as part of the Susquehanna nuclear fuel costs. PPLICA Statement No. 3S, p. 26.

PP&L confirmed that an inappropriate double counting exists with respect to the DOE assessment. See PPLICA Statement No. 3S, Surrebuttal Exhibit LK-4; PP&L Statement No. 8R, pp. 56-57. PP&L suggested that the DOE assessment should remain as a regulatory asset and be removed from the stranded generation quantification. However, the Company did not reflect any change in the treatment of the assessment in the recalculation of stranded costs filed with its rebuttal testimony. PPLICA Statement No. 3S, p. 26.

The Company's proposed solution to the double counting situation is inappropriate. As explained by PPLICA witness Kollen, the DOE assessment is currently on the Company's accounting books as part of nuclear fuel expense. PPLICA Statement No. 3S, p. 27. The logical and appropriate solution to the double recovery problem is to continue to consider the DOE assessment as part of the stranded generation component (which is how other nuclear fuel expense is considered) and to disallow PP&L's regulatory asset claim. Id. Regardless of the Commission's resolution of the appropriate manner of recovery for the assessment, PP&L must rectify the double recovery situation.

7. Susquehanna Deferred Refueling Costs

PP&L includes in its stranded cost claim \$7.996 million (NPV at December 31, 1998) for deferred Susquehanna refueling costs. See PP&L Statement No. 8, p. 22 & Exhibit JRS 1A (Revised).

This deferral of costs is associated with an accounting change by the Company. PPLICA Statement No. 3, p. 36. Because the Commission has not authorized this deferral of the change, the claimed \$7.996 million regulatory asset should be disallowed.

PP&L plans to change the refueling cycle for its Susquehanna 1 and 2 units in 1997 and 1998, respectively. Id. A change in the accounting treatment of the refueling costs must occur concurrent with the change in refueling cycles. However, PP&L has unilaterally decided to defer the change in accounting treatment of the associated refueling costs until "subsequent to 1999." PP&L Statement No. 8R, pp. 45-49. PP&L has not been given authority by the Commission to defer these costs. Consequently, the costs do not qualify as a regulatory asset recoverable as a stranded cost under the Act. 66 Pa. C.S. § 2803. Moreover, the accounting change should occur in 1997 and 1998, concurrent with the changes in operations. PPLICA Statement No. 3S, p. 32. In other words, PP&L manufactured this "regulatory asset" by its unilateral decision to defer costs. No need exists for a post-1999 deferral and the claimed regulatory asset associated with that deferral must be denied. Id.

8. Earnings On Recovered SFAS 106 Costs

SFAS 106 is an accounting requirement enabling companies to recognize post-retirement benefits expense on an accrual basis, rather than on a cash pay-as-you-go basis. PPLICA Statement No. 3, p. 26. PP&L included in its stranded cost calculation as a regulatory asset the unamortized balance of deferrals for the period of January 1, 1993 through September 30, 1995 on a net present value basis of \$8.730 million at December 31, 1998. See PP&L Statement No. 8, p. 22 & Exhibit JRS 1A (Revised). The Company was permitted to accrue these deferrals by virtue of the Commission Order in the Company's 1995 base rate proceeding at Docket No. R-943271.

Although the inclusion of the unamortized balance as a regulatory asset is appropriate because it represents an authorized deferral, in order to be just and reasonable and in accord with the Act's

definition of stranded costs (66 Pa. C.S. §§ 2803, 2802(15), 2808, & 1301) PP&L must also include a regulatory liability associated with SFAS 106. PPLICA Statement No. 3, p. 27. This regulatory liability reflects the fact that the Company has been receiving excess revenues from ratepayers compared to the outlays presently required for the SFAS 106 expense. Id. at 27. A similar regulatory liability was recognized by the Commission in the PECO restructuring proceeding. PECO Restructuring Order, slip op. at 77. As calculated by Mr. Kollen, from 1995 through December 31, 1998, the Company will have recovered \$21.818 million more from ratepayers than required for outlays, and that sum will continue to grow. PPLICA Statement No. 3, p. 27. Consequently, it is proper to include in PP&L's stranded cost calculation a \$53.990 million regulatory liability related to SFAS 106.¹⁷

At some future point under traditional regulation, the balance between the prepayments would switch, and the cash outlays would be greater than the amounts PP&L would be receiving from ratepayers to satisfy its SFAS 106 obligation. PPLICA Statement No. 3, p. 28. However, because the generation function will be unbundled, ratepayers will not receive the benefit of the underpayments that would otherwise occur at that future time. Id. Ratepayers are entitled to recognition and recovery of the benefits of these prepayments regarding SFAS 106 expenses because ratepayers would get this benefit under traditional regulation. Id. at 29.

In addition, permitting PP&L to retain the overfunded portion in the competitive environment is inequitable vis-a-vis ratepayers and future competitors. 66 Pa. C.S. § 2802(8). Without recognizing

¹⁷The Company has included the continued SFAS 106 recoveries from ratepayers in its O&M expense used to calculate the market value of generating units used in the generation stranded cost quantification. PPLICA Statement No. 3, p. 28. This inclusion results in a lower market value and, consequently, higher generation stranded costs than if PP&L had reflected only the required level of SFAS 106 outlays in its O&M quantification. Id. In addition, the computation of SFAS 106 expense utilized by the Company to compute O&M expense is not reduced for the interest income on precollected but uncontributed amounts. PPLICA Statement No. 3S, pp. 28-29.

this liability, the stranded cost calculation will unjustly enrich PP&L shareholders in the amount of this regulatory liability. The regulatory liability for SFAS 106 must be recognized by the Commission in computing PP&L's net regulatory assets for recovery as stranded costs.

9. SFAS 109 (Investment Tax Credit)

PPLICA agrees with the methodology and the calculation performed by PP&L with respect to the SFAS 109 regulatory asset and liability. First, as required by the Act, PP&L recognizes the regulatory liability as a net to the regulatory asset claims. Second, both the regulatory asset and the regulatory liability are calculated on the net present value basis. Third, the amortizations, and thus the net present value of the items, were computed based upon traditional regulation as required under the Act.

* * *

PPLICA is not addressing the following sections: V.C.10; V.C.11; V.C.12; V.D.; and, VI. PPLICA may respond to other parties' arguments as appropriate in a reply brief.

* * *

VII. RECOVERY OF STRANDED COSTS

A. CTC DESIGN METHODOLOGY, INCLUDING FIXED, VARIABLE OR LEVELIZED CTC

The Commission has before it three basic options for how to calculate PP&L's CTC. PP&L and PPLICA propose to use a "fixed" CTC design methodology. The OCA and OSBA propose to use a "levelized" CTC methodology. New Energy Ventures ("NEV") proposes to use a "variable" CTC design methodology. The fixed CTC design, as proposed and implemented by PPLICA, should be adopted by the Commission because it will further development of the competitive market and customer access. Both the variable and the levelized design methodologies are inappropriate and must be rejected.

PP&L and PPLICA propose to calculate the CTC for each rate class for each year based on the fixed CTC design methodology.¹⁸ See PP&L Statement No. 9, pp. 23-26 & PPLICA Statement No. 1, p. 28. The fixed methodology should be adopted by the Commission. The fixed methodology appropriately recognizes that stranded costs and the CTC are a part of the current bundled rates; stranded costs are not simply a number derived disjunctively from the unbundling process and grafted onto each rate schedule (as the stranded costs are treated under the other proposals). Under the Fixed CTC methodology, calculation of the CTC begins with each rate class's bundled rates. The cost of transmission and distribution are removed to produce the generation component. The estimated market price at which electricity will be available in each year is then removed from the generation component to produce the CTC. Id. The CTC is established for each year of the recovery period based on the expected market price of electricity in that year. Because yearly market prices vary, the CTC varies. Id. However, customers will know in advance the CTC for each year of the recovery period.

The OCA's (and OSBA's) levelized CTC methodology is a sharp contrast to the fixed method. The levelized method begins by establishing a firm level of total stranded cost recovery. The utility is permitted recovery of a levelized portion of those stranded costs in each year of the transition period. OCA Statement No. 4, Direct Testimony of Lee Smith, pp. 10-12. Any remaining portion under the rate cap (once transmission, distribution, and the levelized CTC are removed) represents the target price that the customer should attempt to match or better in the competitive market in order to realize a benefit. The projected market prices have no logical relationship to this target price. The logical disconnect between market prices and the CTC level is the fundamental flaw that makes the levelized CTC methodology inappropriate for use in this proceeding. PPLICA Statement No. 1, p. 29.

¹⁸This is also referred to in the testimony as the "CTC residual" methodology.

The variable CTC methodology has absolutely no merit. The variable CTC methodology also begins with the valuation of stranded costs for each rate class. NEV Statement No. 1, Direct Testimony of David Magnus Boonin, p. 9. Next, by some means unspecified in the NEV testimony, the Commission will determine the underlying assumed market price for generation. Id. at 10. The base CTC would be set based on that assumed market price. Each billing period, the EDU would compare the average weighted prevailing market price with the assumed market price. The CTC would be adjusted each billing period to ensure the total of the adjusted CTC and the prevailing market price equal the base CTC and assumed market price. Id. It is evident that the variable CTC method proposed by NEV is too complex and riddled with "assumptions" to be adopted. There is no basis stated in the NEV testimony to predict the "assumed" market price (except for the forecasts submitted by PPLICA, PP&L, and the OCA). In addition, the CTC will vary each month (or billing period) and will be unpredictable month to month and year to year. The proposal offers no reliable basis for customers to shop in the competitive market because customers will not know their CTC responsibility for the following month and whether their alternative supplier is providing a "good deal" as compared to bundled PP&L service.

The fixed CTC methodology as proposed by PPLICA is clearly the most appropriate methodology. **First**, because the projected market price increases each year, the correlating CTC decreases. PPLICA Statement No. 1, p. at 29. This will transition customers to the time when the CTC is no longer being recovered and supply decisions can be made without considering stranded cost liability. **Second**, this method will provide for a more orderly transition to a competitive market because consumers will have a target market price when purchasing energy in the competitive market (*i.e.*, the projected market price for that year). Id. Customers will be able to determine whether the price they are being offered by the competitive supplier will result in savings over PP&L's bundled service as provider of last resort. **Third**, because the target market price and the anticipated market prices are

related (and calculation of the CTC is subordinate to and dependent on projected market price) more consumers will have the opportunity to economically participate in the competitive market. Id. **Fourth**, the methodology avoids problems associated with the allocation of stranded costs among rate classes. These reasons mandate that the Commission adopt the fixed methodology for computing PP&L's CTC.

B. PROHIBITION ON INTER AND INTRA CLASS COST SHIFTING

See Section II.E., supra.

C. CTC RECONCILIATION AND TRACKING

PP&L proposes to keep track of the over- or under-collections of CTC revenues each year (as compared to the test year) and to, near the end of the seven year CTC recovery period, reconcile the over- and under-collections to determine whether the CTC recovery period must be extended or terminated early.¹⁹ PP&L Statement No. 3, pp. 17-19. This proposal is made in the apparent belief that the Commission will grant the Company full recovery of its stranded cost claim.

PPLICA and other parties to this proceeding have produced substantial and compelling evidence that PP&L's stranded cost claim is drastically overstated. For example, PPLICA calculates that PP&L's total stranded cost recovery through the CTC should be \$694.638 million. PPLICA Statement No. 1, Exhibit SJB-2; PPLICA Statement No. 2S, p. 3; PPLICA Statement No. 3S, p. 19.²⁰ Using the residual CTC design methodology and PPLICA market prices, PP&L will recover, on a net present value basis,

¹⁹PP&L requests in this proceeding an automatic extension of the recovery period if this reconciliation shows a net under recovery. PPLICA's opposition to this proposal will be discussed in Section VII.D, infra.

²⁰PPLICA originally recommended stranded cost recovery of \$661.278 million. PPLICA Statement No. 1, Exhibit SJB-2. Revisions made by PPLICA in surrebuttal and by the Company to its regulatory asset claim increased the recommendation to \$694.638 million. See PPLICA Statement 2S, Exhibit RJF-9a Revised; PPLICA Statement No. 3S; PP&L Statement No. 8, Exhibit JRS 1A (Revised). The derivation of the recommended stranded cost recovery level is shown on the summary of adjustment table in Appendix C, infra.

the entire stranded cost revenue requirement recommended by PPLICA in this proceeding by November 1999. PPLICA Statement No. 1, p. 31, Exhibit SJB-5. In such case, the Commission obviously must institute a CTC tracking mechanism during the entire recovery period to determine when the Company has fully recovered its stranded costs. Id. at 23.

PPLICA proposes a monthly tracking mechanism. Id. at 24. The Company would begin the recovery period with the unamortized total stranded cost balance authorized in this proceeding to be recovered from ratepayers. This balance would accrue interest monthly at the revenue requirement level (fully grossed-up cost of capital). Id. Each month, the Company would accumulate the CTC revenues produced that month by each rate schedule. The unamortized stranded cost balance would be reduced each month by the accumulated monthly CTC revenues until the balance is \$0 (fully amortized). At that point, CTC collection will be terminated. Id. The PPLICA proposal represents a reasonable and timely method to track CTC collection and should be adopted by the Commission.

D. CTC AND RATE CAP EXTENSION

PP&L requests that the Commission authorize in this proceeding an extension of CTC recovery period in the event that the Company is not able to fully recover the authorized level of stranded cost revenue. PP&L Statement No. 3, pp. 16-19. PP&L proposes to analyze CTC revenues each year and record any over- or under-collection of actual CTC revenues compared to test year CTC revenue expectations. PPLICA Statement No. 1, p. 25. At or near the end of the seven-year transition period, PP&L proposes to net these yearly over- or under-collections and then to extend or shorten the CTC collection period accordingly. Id.

PPLICA takes no position in this proceeding on whether an extension of the CTC recovery period should be granted or the relevant criteria that the Commission should use in considering any such petition. PPLICA Statement No. 1S, p. 7-8. In addition, PPLICA acknowledges that it is possible that

PP&L will not be able to fully recover their litigation position stranded costs over the statutory seven-year CTC period. PPLICA Statement No. 1, p. 26. However, the Commission should not in this proceeding grant PP&L what amounts to an automatic extension of the CTC based on the PP&L CTC revenue tracking mechanism. If such undercollection is present at the end of the statutory CTC recovery period, the Company should present the evidence of the undercollection to the Commission and seek approval for an extension.²¹ Id. This represents a reasonable compromise between the need for PP&L to recover its allowed level of stranded costs and the need for the other market participants to ensure that the transition period is not unreasonably extended. See 66 Pa. C.S. § 2802(8).

Furthermore, any extension of the CTC recovery period must be accompanied by a correlating extension of the rate cap pursuant to Section 2804, 66 Pa. C.S. § 2804(4). PPLICA Statement No. 1, p. 27. The rationale for including a rate cap in the Act was to protect the consumers who were held captive to the payment of a CTC. Id. The concerns that lead to that adoption will be present if the CTC recovery period is extended and the consumers remain captive to the payment of a CTC. In addition, not extending the rate cap would inappropriately benefit PP&L without a correlating benefit to ratepayers in violation of Section 2802(8) of the Act, 66 Pa. C.S. § 2802(8). Consequently, the rate cap must also be extended if and when the CTC recovery period is extended.

E. RETURN ON UNAMORTIZED CTC BALANCES

PPLICA is not addressing this issue but may respond, as appropriate, in a reply brief.

²¹This process would involve no revisiting of the stranded cost determination made in this proceeding. PPLICA Statement No. 1S, pp. 8-9.

F. CALCULATION OF CTC APPLICABLE TO INTERRUPTIBLE SERVICE CUSTOMERS

PP&L submitted unbundled tariffs for the interruptible rate schedules (IST, ISP and ISA). PP&L Statement No. 11, Direct Testimony of Oliver G. Kasper, Exhibit OGK 2, pp. 19B, 30A-30B.2, & 30C-30F. PP&L proposed changes in the terms and conditions of the rate schedules that must be rejected. Specifically, PP&L changed the availability term of the tariff in a manner that clearly violates the Act.²²

Under the PP&L proposal, interruptible tariffs will only be available to current interruptible customers that remain bundled sales customers of PP&L; current interruptible customers exercising their statutory right of access to service from a competitive provider would be charged a CTC based on the firm rate schedule applicable to their level of load (e.g., LP-4, LP-5 or LP-6) instead of the unbundled CTC contained in their existing IST, ISP or ISA rate schedule. Id.; See also PP&L Statement No. 11, p. 15. PP&L specifically includes the following restriction in the tariff:

Service under this rate schedule is available only to existing service locations supplied on and continuously after January 1, 1999 and only to customers who do not choose an alternative generation supplier and for whom the Company supplies all of the Customer's capacity and energy on and continuously after January 1, 1999 pursuant to Section 2807(E)(3) of the Customer Choice Act.

PP&L Statement No. 11, Exhibit OGK 2, pp. 30A, 30C, and 19B. No similar restriction is in the current tariff. PP&L has almost surreptitiously chosen to use this proceeding as a vehicle for making significant tariff and rate schedule availability changes to the extreme detriment of its customers. In addition, the restriction is unreasonable and anti-thetical to the fundamental tenants of the Act — offering customers choice. The proposal is completely self-interested and must be rejected.

PP&L's limitation on the availability of interruptible service to only the customers that continue to take bundled service denies interruptible customers the opportunity to participate in direct access.

²²Other changes to terms and conditions of the tariff will be discussed in Section VIII.C, infra.

Chapter 28, however, guarantees all customer classes the right to participate in the competitive market. 66 Pa. C.S. § 2804(2). As the Commission recognized in the PECO restructuring proceeding, customers currently on interruptible tariffs must be permitted to remain on the unbundled interruptible tariff while taking service from an alternative supplier because “[t]here is no statutory suggestion that any class of customers can be denied the opportunity to shop.” PECO Restructuring Order, slip op. at 118. Because interruptible customers must be permitted to remain on the unbundled interruptible tariff, an interruptible customer can be charged only the CTC contained in the interruptible tariff **regardless of whether the interruptible customer takes service from an alternative supplier.**

In addition, the PP&L proposal is unlawful, unreasonable, anti-competitive, injurious to economic development, and wholly inconsistent with Chapter 28. Stranded costs are embedded in each customer’s rates and must be unbundled within the constraints of Chapter 28. 66 Pa. C.S. § 2808(a). Nothing in the Act permits the customer’s stranded cost liability to drastically change by virtue of accessing the competitive market. The only possible motivation for this proposal by PP&L is economic blackmail to retain the interruptible customers by denying them a choice for competitive supply.

Stranded costs are embedded costs of generation resources in current bundled rates that may no longer be recoverable under competitive conditions. PPLICA Statement No. 1, p. 46. As an embedded cost, the stranded cost must be unbundled along with the other components of the rate pursuant to the rate cap and anti-cost shifting provisions of the Act. See 66 Pa. C.S. §§ 2808(a) & 2804(7). This embedded cost associated with stranded costs is logically (and in reality) smaller with respect to interruptible customers than with firm customers. The smaller stranded cost liability associated with current interruptible customers is evidenced by the lower CTC contained in the PP&L proposed “unbundled” interruptible rate schedules compared to PP&L’s firm rate schedules. See PP&L Statement No. 11, Exhibit OGK 2, pp. 30A-30B & 30C-30D. PP&L proposes to change this liability based solely

on the customers' desire to exercise the right of direct access to the competitive generation. Tr., p. 1067, Aug. 20, 1997 (Oliver G. Kasper). The exercise of this right in no manner changes the fact that the Company, in the regulated market, had relied on the interruptible customer as a generation capacity equivalent resource and, as shown in the interruptible CTCs, incurred very little embedded generation costs on behalf of interruptible customers that could now possibly be considered to be "stranded." See PP&L Statement No. 11R, Rebuttal Testimony of Oliver G. Kasper, pp. 3-4. It is unreasonable and contrary to logical cost causation principles to charge interruptible customers a higher CTC if they choose to exercise their competitive alternatives; accessing the market does not change the fact that interruptible customers were not a major cause of the PP&L past capacity additions in order to provide reliable service. PPLICA Statement No. 1, pp. 45-46.

PP&L witness Kasper confirmed both the embedded nature of stranded costs and that the proposed change in CTC liability is based solely on the exercise of the right to direct access:

Q. But inherent in today's rates, Mr. Kasper, hasn't the company been told by the Commission that it can only charge a given level of rate on the IS-P and IS-T tariffs by virtue of the last rate case decision?

A. That's correct.

Q. And doesn't the statute now require us to unbundle rates at their current levels and keep those levels at capped rates?

A. On a rate class basis.

Q. Okay.

A. For customers who qualify for those rates.

Q. And inherent in the rate cap, Mr. Kasper, isn't there some number of stranded costs in every rate schedule throughout PP&L's system, IS-P and IS-T included?

A. Yes.

Q. And whatever that inherent level is, you have calculated in the unbundling of that tariff, as required by the statute, that produces the CTC charges that we read through on the IS-P and IS-T schedule?

A. Yes.

Q. And the mere fact of exercising a customer's rate [sic] to direct access is what is triggering the change in that CTC level for that customer?

A. That's correct.

Tr., p. 1066-67, Aug. 20, 1997 (Oliver G. Kasper). This Commission cannot support a major change in stranded cost liability that is premised solely on the customer's exercise of the very right guaranteed by the Act — direct access.

In addition, the PP&L proposal violates several portions of Chapter 28. First, the proposal results in cost shifting in violation of Section 2808, 66 Pa. C.S. § 2808(a). PPLICA Statement No. 1, p. 46. This cost shift occurs in two ways: (1) the interruptible customer is paying a different and higher rate by exercising the right of access; and, (2) PP&L will collect more CTC revenues from interruptible customers than it would otherwise collect if the customers were charged the interruptible service CTC, resulting in an earlier termination of the CTC and all other customers on the PP&L system paying a lower CTC because of the earlier termination. Id. at 48. PP&L witness Kasper acknowledged that PP&L's proof of revenue assumes that no interruptible customers will switch to alternate suppliers (and consequently to a firm rate schedule CTC) and that, all else being equal, if interruptible customers do switch to alternate suppliers more CTC revenues will be collected from them resulting in termination of the CTC at an earlier date and all other remaining customers paying less total dollars in CTC. Tr., pp. 1058-59, Aug. 20, 1997 (Oliver G. Kasper). This is exactly the type of cost shifting between classes that is prohibited by Chapter 28; i.e. charging one customer class higher rates than contained in the class's bundled rates in order to charge other classes less. 66 Pa. C.S. §§ 2808(a) & 2804(7).

Furthermore, the PP&L proposal violates the pro-competition goals of Chapter 28 because it effectively prevents the interruptible customers from entering the alternate generation supply market. PPLICA Statement No. 1, p. 47. As explained by PPLICA witnesses James Schneider of R.R. Donnelley & Sons and Jay Rooney of Armstrong World Industries, imposition of the firm LP-4, LP-5 or LP-6 CTC and delivery charges on a current interruptible customer pursuing competitive options will effectively and economically force interruptible customers to remain captive PP&L bundled service customers. See PPLICA Statement No. 4 & PPLICA Statement No. 5. The imposition of the PP&L proposal will deny interruptible customers the very right guaranteed by Chapter 28 — the right of access to the competitive market for generation supply.

Moreover, the PP&L proposal will violate the pro-business growth goals of Chapter 28. 66 Pa. C.S. §§ 2802(6) & (7). One of the main reasons that the electric generation supply market has been restructured is to provide businesses with lower electricity prices, thus attracting new businesses to Pennsylvania and encouraging existing businesses to remain and expand operations in Pennsylvania. The General Assembly made the following findings:

(6) The cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in the Commonwealth.

(7) This Commonwealth must begin the transition from regulation to greater competition in the electricity generation market to benefit all classes of customers and to protect this Commonwealth's ability to compete in the national and international marketplace for industry and jobs.

Id. As explained by Messrs. Schneider and Rooney, many large corporations have multiple plant locations throughout the United States and the world, and make decisions on where to site new plants or whether to expand operations at an existing plant based largely on the costs of production at the plants. See PPLICA Statement No. 4 & PPLICA Statement No. 5. The PP&L proposal results in aggregate annual CTC charges of PPLICA members taking interruptible service from an alternative

supplier being over \$10 million higher than if the CTC was calculated based on the interruptible rate schedule. PPLICA Statement No. 1, pp. 48-49. Imposition of a firm rate CTC instead of an interruptible CTC will greatly effect the costs of doing business in Pennsylvania and, consequently, those critical business decisions. Businesses will not locate or expand production in Pennsylvania in the face of a draconian measure such as the PP&L proposal.

Even PP&L witness Dr. Susan Tierney, one of the witnesses addressing rate design and policy issues for the Company, could not explain how the PP&L proposal is consistent with the purpose of retaining and expanding industrial customer load contained in the goals of Chapter 28.

Q. I think we had agreed that one of the purposes of passing Act 138 in Pennsylvania was that the cost of electricity is an important factor in determining whether businesses locate, expand or change facilities in Pennsylvania?

A. Agreed.

Q. And I'm asking you whether or not the proposal by PP&L, which would result in higher CTC charges for interruptible customers which would occur only if that customer exercised the direct access rights under the statute, is in keeping with promoting economic development and retention in the Commonwealth of Pennsylvania?

A. The interruptible rate looks to me as though it has dual benefits today. One of them is to the customer, because there is essentially a rate that reflects the discount associated with firm capacity.

Q. I think you can answer this question without getting into the purpose of the underlying rate.

MR. KLEPPINGER: I think the question calls for a yes or no answer, Your Honor.

JUDGE KASHI: Can you answer the question?

THE WITNESS: I can't answer it yes or no.

JUDGE KASHI: She can't answer it yes or no, Mr. Kleppinger.

MR. KLEPPINGER: Then I don't want an answer, Your Honor.

Tr., pp. 855-56, Aug. 19, 1997 (Susan F. Tierney). Not even the Company's witness can reconcile this clearly anti-competitive proposal with the dictates of the Act. The proposal is unreasonable and must be rejected.

Moreover, PP&L does not limit its anticompetitive efforts to industrial customers. The Company also proposes a similar switch of CTC responsibility with respect to residential customers on rate schedules RTD or RTS that access a competitive supplier. PP&L Statement No. 11, Exhibit OGK 2, pp. 21 & 22. The "availability" section of both proposed rates states as follows:

Service under this rate schedule is available only to customers who do not choose an alternative generation supplier and for whom the Company supplies all of the customer's capacity and energy on and continuously after January 1, 1999 pursuant to Section 2807 (E) (3) of the Customer Choice Act.

Id. As with the current interruptible tariff, the current RTD and RTS tariffs do not contain such a restriction. The incremental change in the CTC for these customers would be 15% for RTD customers and 97% for RTS customers if those customers choose an alternative supplier. See Gilberton Ex. No. 1. There is absolutely no basis in the Act for nearly doubling a customer's stranded cost responsibility based solely on that customer accessing the competitive market. This proposal must be rejected on the same rationale as previously set forth for rejecting the related interruptible proposal.

VIII. RATE DESIGN AND TARIFFS

A. CUSTOMIZED RATE DESIGN

As part of its filing, PP&L proposed a mandatory "customized" CTC design for large service customers.²³ PP&L Statement No. 9, pp. 32-34. Through this proposal, PP&L will collect 50% of the customer's monthly CTC charge on a fixed dollar per month basis and the other 50% based on

²³Large service customers include LP-4, LP-5, LP-6, IST, ISP and ISA. The customized CTC is available to residential customers on an optional basis.

consumption.²⁴ The Commission must reject this proposal because it violates the rate cap and cost shifting provisions of the Act (66 Pa. C.S. §§ 2804(4) & 2808(a)) and because PP&L has presented no valid justification for the extraordinary proposal. In addition, the proposal is contrary to the purpose and intent of the Act because it harms customers whose load is decreasing due to negative business concerns.

The PP&L proposal violates the rate cap and cost shifting prohibitions contained in Chapter 28. 66 Pa. C.S. §§ 2808(a) & 2804(4). As explained by PPLICA witness Baron, the customized rate amounts to a take-or-pay charge for 50% of stranded costs recoverable by PP&L. PPLICA Statement No. 1, p. 41. No such take-or-pay liability is currently in PP&L's bundled rates for large service customers. Consequently, on a risk adjusted basis, PP&L customers forced to use the customized design will pay higher rates than they would otherwise pay under currently applicable bundled service rates. Id. at 42. PP&L witness Tierney admitted that the PP&L rate redesign involves a shifting of revenue recovery from a usage rate to a customer charge, which traditionally has been a form of intra-class revenue reallocation. Tr., p. 842, Aug. 19, 1997, (Susan F. Tierney). Dr. Tierney further acknowledged that the rate redesign represents a change from embedded cost-developed rates to marginal cost-based rates. Id. at 850. The "redesign" changes cost allocations based on embedded costs in PP&L's bundled rates that are specifically mandated to remain constant under the Act. 66 Pa. C.S. § 2808(a). Moreover, in a traditional environment, the redesign would be labeled a cost shift, which is prohibited under the Act. Id. The Commission cannot accept a proposal with such blatant defects.

In addition, the PP&L proposal eviscerates the economic development goal of Chapter 28 regarding the retention of businesses in the Commonwealth. One of the policy findings of Chapter 28

²⁴The customer's total monthly CTC responsibility will be calculated based on the 1996 usage. Half of that amount will be collected through the fixed monthly charge. The other half of that amount will be collected on a per kWh basis. Residential customers have the option of paying total monthly amount on a per kWh basis. PP&L Statement No. 9, pp. 32-33.

is that "the cost of electricity is an important factor in decisions made by businesses concerning locating, expanding **and retaining facilities in this Commonwealth.**" 66 Pa. C.S. § 2802(6) (emphasis added). The average CTC per kWh for customers with declining loads will be greater under the customized rate design as opposed to traditional CTC rate design. Tr., pp. 756-57, Aug. 19, 1997 (Douglas A. Krall). As admitted by PP&L witness Krall, this would result in a struggling customer paying a higher average cost for electricity, which is inconsistent with the business retention purposes underlying Section 2802(6) of the Act. Economic development involves attracting new businesses and retaining current businesses. The PP&L proposal will place higher costs on a struggling business at the precise time that the business must be cutting costs to survive. A proposal that obviously impedes the economic development purposes of the Act must be rejected.

Furthermore, the PP&L rate design is a completely self-interested proposal. Through the customized rate design, PP&L is able to shift to large customers the risk of the variability of usage. PPLICA Statement No. 1, p. 42; Tr., p. 843, Aug. 19, 1997 (Susan F. Tierney). The imposition of this take-or-pay charge substantially reduces the risk of recovery associated with 50% of the otherwise applicable stranded cost recovery through the CTC charge. Id. Although Dr. Tierney attempted to explain how the redesign also has beneficial risk management implications for customers, in the end she admitted that the positive effect for customers was negligible, if at all. Tr., pp. 844-45, Aug. 19, 1997 (Susan F. Tierney). This proposal benefits only PP&L and must be rejected.

Moreover, the Company has offered no valid justification for this action. The Company has failed to produce any evidence to support its claim that economic efficiency will be enhanced by the proposal. PPLICA Statement No. 1, p. 41. Because the proposed rate has not become effective, PP&L has the burden of establishing its reasonableness. 66 Pa. C.S. §§ 315(a) & 332(a). The Company's unsupported assertion that the proposal is intended for rate design "simplicity" (PP&L Statement No.

9R, p. 28) is flawed. It is simply hard to understand how the Company can assert that calculating a unique, fixed, mandatory take-or-pay charge for each customer can in any way be construed as a simplification. PPLICA Statement No. 1S, p. 10. The two bases asserted by the Company for this proposal are clearly invalid. To the contrary, PPLICA has demonstrated that the proposal has serious anti-competitive effects and otherwise violates Chapter 28. The PP&L proposal must be rejected.

PP&L presented an alternative proposal during oral rejoinder testimony. The Company is willing to make the customized CTC optional for all customer classes on two conditions:

1. The election of the customized or traditional CTC must remain in effect for a minimum of 12 months.
2. PP&L will clarify the CTC reconciliation proposal to track each years CTC based on actual CTC revenue for the period, instead of based on sales as previously proposed.

Tr, pp. 734-35, Aug. 19, 1997 (Douglas A. Krall). In the event that the Commission rejects PPLICA's arguments to completely eliminate the customized design, the PP&L alternative proposal would be acceptable.

B. CLOSURE OF EXISTING ECONOMIC INCENTIVE RATES

In 1987, PP&L placed an Economic Development Initiative ("EDI") credit in its tariff. PP&L Statement No. 11, Exhibit OGK 1, pp. 19-19A. The EDI credit encourages businesses to expand facilities or production by offering a discount on electricity. Id. An Industrial Development Initiative ("IDI") credit available only to industrial customers was introduced in 1995. Id., p. 19D. These incentive credits were originally proposed to be phased-out on January 1, 2000. Id.

As part of its restructuring filing, PP&L proposes to extend these credits until 2005. PP&L Statement No. 11, p. 9, Exhibit OGK 2, pp. 19 & 19D. Lee Smith, testifying on behalf of the OCA, argues that these credits should be phased out as originally planned. OCA Statement No. 4, Direct

Testimony of Lee Smith, p. 7. The OCA's proposal must be rejected because it violates the rate cap and anti-cost shifting provisions of the Act. 66 Pa. C.S. §§ 2804(4) & (7).

Chapter 28 guarantees that rates are capped at their January 1, 1997, level for the entirety of the transition period. 66 Pa. C.S. § 2804(4). Eliminating the credits before the end of transition period will result in an increase in rates from the January 1, 1997, level for customers receiving those credits as of January 1, 1997. PP&L Statement No. 10, p. 9. Because elimination of the credits will increase the current IDI and EDI customers' rates above January 1, 1997, levels, phasing out the credits will violate the rate cap contained in Chapter 28 for EDI and IDI customers. PPLICA Statement No. 1R, p. 15.

Chapter 28 also prohibits shifting costs between classes. 66 Pa. C.S. §§ 2804(7) & 2808(a). If the credits are eliminated before the end of the transition period, inappropriate cost shifting will occur, again in violation of the Act. PPLICA Statement No. 1R, p. 15. If the credits are eliminated, PP&L will have extra resources available in the amount of the previously given credits. PP&L can either use these resources to benefit other rate classes (through lower rates) or to benefit shareholders (which it appears from the Company's testimony is not the intended use of the extra resources). Id. If the proceeds are used to benefit other ratepayers, inappropriate cost-shifting will occur in violation of Chapter 28. Id. It would be equally inappropriate, of course, to use the proceeds to benefit shareholders. Increasing a customer's rates through elimination of a previously available initiative rider necessarily shifts costs to that customer as evidenced by a higher bill not containing the credit. The OCA proposal is unreasonable and violates the rate cap and anti-cost shifting provisions of the Act.

In addition, the Commission stated in the PECO decision that,

All existing tariffs shall remain available throughout the transition period, and all special contracts shall remain in force, except as modified pursuant to this Opinion and Order or other tariff modifications approved by the Commission.

PECO Restructuring Order, slip op. at 117. The Commission mandated that PECO continue to offer rates such as PECO's Economic Efficiency Rider ("EER") to existing customers until the end of the transition period. Id. at 118. The Commission should afford equivalent protection to the customers on economic development rates in the PP&L service territory. The OCA's proposed elimination of the IDI and EDI credits prior to the end of the transition period must be rejected.

C. TERMS AND CONDITIONS MODIFICATIONS TO EXISTING TARIFFS

PP&L proposes to make three terms and conditions modifications to tariffs that are inappropriate and must be rejected. First, the Company proposes to make certain rates (IST, ISP, ISA, PRS-1 and PRS-2) available only to PP&L bundled service customers. Second, PP&L proposes significant changes to interruptible rates regarding the frequency and duration of economic interruptions. Third, PP&L proposes to change the calculation of the charge for an interruptible customer to buy through (take service during) an economic interruption. As detailed below, all three proposals constitute material modifications to existing tariffs in violation of the Act. In addition, the changes are anti-competitive and otherwise at odds with the central premises of the Act. All three proposals must be rejected.

1. Availability of ISA, ISP, IST, PRS-1 and PRS-2 Rates

The proposed tariffs for the interruptible service and price response rate schedules require the customer to take all of its energy from PP&L in order to qualify for the specific rate. PP&L Statement No. 11, Exhibit OGK 2, pp. 19B, 30A, 30C, 31, & 32. Apart from PPLICA's concerns regarding the calculation of the CTC for former interruptible and PRS customers that enter the competitive generation

market,²⁵ this sole provider provision is unreasonable and will significantly deter the ability of interruptible and price response customers to participate in the competitive market during phase-in. PPLICA Statement No. 1, p. 53. The proposal is thus at odds with the central pro-competitive concepts of the Act and must be rejected. 66 Pa. C.S. §§ 2802(12) & (13).

Customers must have the option to remain on these rate schedules for a portion of their load. The PPLICA proposal regarding the phase-in of retail access will permit all desiring customers to have a portion of their load participate in each stage of phase-in. See Section IX, infra. If the PPLICA pro-rata phase-in is adopted, an interruptible or price response customer wanting to participate in the market during phase-in would be forced to revert to PP&L's firm service for the remaining portion of load.²⁶ See PPLICA Statement No. 1, p. 53. This will result in a substantial rate increase for these customers and will deter their ability to participate in direct access during phase-in. Id. This restriction will severely limit the ability of interruptible and price response service customers to exercise the right to direct access granted by the Act. These rate schedules (IST, ISP, ISA, PRS-1 and PRS-2) must permit customers that nominate a portion of their load for direct access during phase-in to remain on the current bundled service rate for the remaining portion of their load. Id. at 54.

²⁵As explained in Section VII.F., supra, current interruptible customers that leave bundled service to take supply from an alternate supplier should be charged a CTC based on the interruptible rate schedule, not based on a firm rate schedule as is proposed by PP&L. This CTC switch is also an inappropriate limitation on the availability of these rates.

²⁶As explained by PP&L witness Kasper, as soon as a price response customer "has access to alternate suppliers, not necessarily taking service, but access," the customer cannot remain in the PRS-1 or PRS-2 rate. Tr., pp. 1069-70. In other words, because all customers will have access to alternative suppliers under the Company's phase-in proposal by January 1, 2001, these rates will effectively cease to exist as of that date. Moreover, because all customers will have access for at least 33% of their load on January 1, 1999, under the PPLICA proposal, all price response service will cease at that time.

2. Frequency and Duration of Economic Interruptions

PP&L also proposes to make significant changes to its tariff regarding the frequency and duration of economic interruptions for interruptible customers. Specifically, PP&L has completely eliminated portions of the tariff limiting both the frequency and duration of such interruptions. PP&L's current bundled interruptible tariffs contain the following limitation on interruptions:

Load interruptions may be called by the Company as required for economic load control, for system and local emergencies, and for tests of the customer's ability and readiness to interrupt load during an emergency. The frequency of load interruptions shall be no more than 20 per calendar year with such interruptions being no more than 10 hours in any one day; or more than five days in any single month; or more than 200 hours in a calendar year.

PP&L Statement No. 11, Exhibit OGK 1, pp. 30B & 30D. The proposed tariff eliminates the restrictions with respect to economic interruptions.

Load interruptions may be called by the Company as required for economic load control, for system and local emergencies, and for tests of the customer's ability and readiness to interrupt load during an emergency. The frequency of load interruptions for emergencies shall be no more than 20 per calendar year with such interruptions being *no more than 10 hours in any one day; or more often than five days in any single month; or more than 200 hours in a calendar year.* **The frequency and duration of economic interruptions shall be unlimited.**

Id., Exhibit OGK 2, pp. 30B.1 & 30-F (emphasis added).

The elimination of the limits on economic interruptions represents a material change in the terms of interruptible rate schedules. As explained by PPLICA witness Baron, eliminating the limitations effectively raises the cost for PP&L interruptible customers over and above the level of rates as of January 1, 1997, in violation of the Act's rate cap. PPLICA Statement No. 1R, p. 14. In effect, PP&L has diminished the value of the service it is willing to provide interruptible customers but has not diminished the capped price that interruptible customers will pay during the transition period. This diminution in value violates the price cap in Section 2804(4) as much as a blatant rise in the tarified

price would. 66 Pa. C.S. § 2804(4). Under the PP&L proposal, interruptible customers are getting less valuable service than they were under the regulated environment. This is anti-thetical to the need for a fair and orderly transition to full competition. Id. § 2802(13). The proposal must be rejected.

Furthermore, the diminution in the value of interruptible service has already begun to occur. PP&L called four days of economic interruptions the summer of 1997. Tr., p. 1081, Aug. 20, 1997 (Oliver G. Kasper). The Company called no economic interruptions prior to 1997. Id. This new propensity to call interruptions and the many anti-competitive, anti-customer proposals presented in this case by PP&L evidence a nefarious intention to thwart the competitive alternatives of some of its largest customers. The Company cannot be permitted to diminish its level of service during the transition period while the ratepayers are still held captive to the payment of the CTC.

Moreover, the Company, due to an "oversight" (Id. at 1076), has offered no evidence to explain the rationale or support for the reasonableness of, these proposed changes. The Company failed to mention this very important change in its direct testimony. The Company never acknowledged the change until Oliver Kasper was on the witness stand for cross-examination. Id. Even when Mr. Kasper discussed the change, he gave no rationale to establish the reasonableness of the change. See Id. at 1073-1076. The burden of proof as to the reasonableness of a rate change remains on the utility if a complaint is filed prior to the change becoming effective. 66 Pa. C.S. §§ 315(a) & 332(a); See e.g., Pennsylvania Power Co. v. Pennsylvania Pub. Util. Comm'n, 155 Pa. Commw. 477, 625 A.2d 719, appeal denied, 536 Pa. 628, 637 A.2d 288 (1993). PP&L has not submitted a shred of evidence to support this change. PPLICA, on the other hand, demonstrated that the change is a violation of the Chapter 28 rate cap and must be rejected. 66 Pa. C.S. § 2804(4).

3. Interruption Buy Through Price

A third modification to interruptible service proposed by PP&L involves the price charged to a customer that chooses to "buy through" an interruption. Interruptible customers have two options when notified by PP&L of an economic interruption: (1) the customer can cease operations at the facility; or, (2) the customer can continue operating and pay a penalty charge to "buy through" the interruption. Tr., pp. 1076-77, Aug. 20, 1997 (Oliver G. Kasper). The current charge for this buy through is the sum of the charges normally incurred by the customer under the rate plus the PJM billing rate for the buy through period. PP&L Statement No. 11, Exhibit OGK 1, pp. 30B & 30D. The proposed tariff modified this language and states that the buy through charge will be the otherwise applicable charges plus the "estimated replacement capacity of energy cost." Id., Exhibit OGK 2, pp. 30B.1 & 30F.

This is yet another tariff change that Mr. Kasper forgot to mention in his direct testimony. Tr., p. 1079, Aug. 20, 1997 (Oliver G. Kasper). On cross-examination, Mr. Kasper explained that the company anticipates using the estimated spot price during the buy through. Id. at 1078. No true-up mechanism will be used to ensure that the spot price that PP&L "estimates" and charges the customer is equal to the actual spot price during the interruption. Id. This proposal is unreasonable, unsupported, and violative of the Act; consequently, the proposed buy through calculation change must be rejected.

First, the Company has failed to sustain the burden of proving the reasonableness of the change because the Company failed to ever mention the change in testimony submitted in this proceeding. Id. A short exchange on cross-examination between Mr. Kasper and counsel for PPLICA is the only discussion of the change in evidence in this proceeding. That cross-examination, moreover, was not aimed at discovering the rationale for the change; rather, the cross-examination sought to clarify the proposal so that customers will have some idea of the buy through charge that the Company could

impose on them if the proposed change is adopted. See Id. at 1078. PP&L has failed to meet the burden of proof and its proposal must consequently be rejected by the Commission.

Second, the buy through proposal is unreasonable. The PP&L proposal provides no certainty to interruptible customers regarding what price will be charged to buy through an interruption. Moreover, the proposal does not include any type of true-up to the actual spot price during the hours the customer buys through an interruption. Id. at 1079. It is inequitable and unreasonable to not base the buy through penalty on the actual costs incurred by PP&L to provide the service to the customer during the interruption.

Third, the proposal violates the generation rate cap in Chapter 28. 66 Pa. C.S. § 2804(4). The proposal replaces a specific and knowable price term in the interruptible tariff (the PJM Interconnection billing rate) with an "estimate" that the witness admits may be higher than the actual spot market price. Tr., p. 1079, Aug. 20, 1997 (Oliver G. Kasper). If PP&L "estimates" incorrectly, then the customer will pay more to buy through the interruption than it would under the rates in effect on January 1, 1997. 66 Pa. C.S. § 2804(4). This is clearly impermissible under the Act and must be rejected.

4. Conclusion

All three proposals are clearly anti-competitive and violative of Chapter 28. Examined in the aggregate, the negative effects of the three proposed modifications are magnified in a synergistic effect. The following exchange between Mr. Kasper and counsel for PPLICA captures the unreasonableness of the cumulative PP&L proposals.

Q. Mr. Kasper, do you agree with the policy declaration in the Electricity Generation Customer Choice and Competition Act that states that the cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this commonwealth?

A. Yes.

Q. Is it PP&L's position that the proposed changes to the IS-P and IS-T tariff, insofar as they relate to the competitive transition charge that we've been discussing, the increase in the interruptibility that we've been discussing, and the change in the pricing of the buy-through that we've been discussing, serve the economic development and business retention interests of the commonwealth?

A. In general, I think our overall tariff supports the economic development of the act itself. Being that the interruptible customers moving off to another tariff, or whatever, cannot find a deal in the open market as good as what PP&L's supplying at this time points to the fact of the size of that credit is probably better than what they're going to get in the open market. So, if they do stay with PP&L, they are getting the benefits of a very good economic development rate.

Q. But Mr. Kasper, hasn't the deal, as you referred to it, changed in this proposed tariff? Number one, the proposed tariff requires them to buy 100 percent of their requirements; number two, the interruptibility has become unlimited for economic interruptions; number three, if they move from the system, their CTC is charged higher; and number four, the charge for a buy-through is different and perhaps higher than the existing tariff. Hasn't the structure of the tariff changed?

A. The structure of the pricing has not changed, the structure of some of the provisions of the rate have changed.

Q. And do you think the structure of those changed provisions are beneficial or harmful to the customer in terms of quality of service and pricing service?

A. I would say it would depend on what the customer chooses. If he chooses to stay with the rate they're probably not going to be harmful for the customer.

Q. They can get interrupted a lot more frequently.

A. They may.

Q. They may. And in fact, hasn't PP&L called four days of economic interruptions this summer?

A. Yes.

Q. And how many economic interruptions did they call prior to 1997?

A. None.

Tr., pp. 1079-1081, Aug. 20, 1997 (Oliver G. Kasper).

The Company has completely and utterly failed to support its proposed tariff changes. One of two conclusions must be drawn from the failure of PP&L to even mention two of the important changes in direct testimony. Either PP&L was attempting to surreptitiously make these changes to its tariff, or PP&L cannot recognize obvious changes that violate Chapter 28 and that will have a substantial adverse effect on customers. In either event, the Commission must reject the testimony of the Company witnesses on these issues and reject the proposed tariff changes. PPLICA has demonstrated the stark anti-competitive and anti-economic development effects the proposed tariff changes will have on the competitive electricity market in Pennsylvania and on customers' access to that market. The proposals completely undermine the policies of the Act and must be rejected.

D. ALLOCATION OF UNIVERSAL SERVICE CHARGES

The Act requires that universal programs continue to be funded at the current level and that all customer classes share in the costs of such programs. 66 Pa. C.S. §§ 2802(17), 2804(8) & (9). The Commission determined in its Final Order regarding Universal Service Issues (Docket No. M-960890F00010) that the Act requires that universal service charges must be funded in accordance with each class' responsibility as established in the utility's last base rate case. Universal Service Order, slip op. at 20. In doing so, the Commission relied on the prohibition against inter- and intra- class cost shifting (66 Pa. C.S. § 2804(7)) and on the duty to ensure just and reasonable rates (66 Pa. C.S. § 1301). Id. In addition, the Commission adhered to this precedent in allocating the universal service cost recovery for PECO. PECO Restructuring Order, slip op. at 146.

PP&L properly adhered to the dictates of the Commission's Order by determining what portion of each rate class' bundled rates corresponded with the Company's universal service program obligations. PP&L Statement No. 9R, pp. 38-39. This approach is fully consistent with both the Act

and with the Commission's Orders. PPLICA Statement No. 1R, p. 3. The PP&L allocation of its universal service cost recovery should be accepted by the Commission.

Chapter 28 recognizes that universal service costs are embedded in the utility's bundled rates. 66 Pa. C.S. § 2802(17). Universal service costs were in PP&L's bundled rates predominately as uncollectibles expense. PPLICA Statement No. 1R, pp. 3-4. In PP&L's last base rate case, uncollectibles expense was primarily assigned to the residential and general service classes. Id. at 3-4. Because the Act requires that rates be unbundled based on the embedded components as established in the last base rate proceeding, changing the allocation embedded in rates would violate the cost shifting restrictions in the Act. 66 Pa. C.S. § 2804(7). The Commission relied on the previous allocation in PECO's last base rate proceeding and the Act's cost shifting prohibition to allocate PECO's universal service cost recovery solely to the residential class. PECO Restructuring Order, slip op. at 146. The Commission should apply a similar conceptual framework in approving PP&L's proposed allocation.

In addition, assigning universal service costs predominately to the residential and general service classes is reasonable and follows sound cost of service ratemaking principles. PPLICA Statement No. 1R, p. 4. Cost of service ratemaking mandates that costs be recovered from the ratepayers for whom the costs were incurred to serve. As explained by PPLICA witness Baron, universal service costs, such as uncollectibles expense, are primarily associated with service to residential customers. Id. The Act also specifically defines universal service as benefitting low-income customers. 66 Pa. C.S. § 2803. Therefore, following cost of service ratemaking principles, the universal service costs should be allocated primarily to the residential and general service classes. PPLICA Statement No. 1R, p. 4.

Other parties have proposed that universal service costs be allocated to customer classes on a non-bypassable, kWh basis. See, e.g., AARP Statement No. 1, pp. 21 & 30-31. These proposals violate

the Act and cost causation principles of ratemaking. As explained above, the Act and the previous Commission Orders require that universal service costs be allocated in the manner currently in bundled rates. The Commission's Universal Service Order specifically considered and rejected allocating universal service costs on a kWh basis.

Several commentators support a kWh assessment on all customer classes. We cannot accept this recommendation because it places a disproportionate responsibility for funding universal service and energy conservation programs on high kWh (high volume) users in violation of Section 1301. Further the Act at § 2804(7) prohibits interclass and intraclass cost shifting. Assessing a funding mechanism on kWh use is inconsistent with rate treatments for these programs in recent base rate cases.

Universal Service Order, slip op. at 20. Thus, a kWh assessment has been specifically rejected by this Commission. The Commission should adhere to this precedent.

In addition, the OCA proposes that universal service costs be allocated to classes based on a non-production demand allocator. OCA Statement No. 6S, Surrebuttal Testimony of Nancy Brockway, pp. 20-23. This proposal violates the cost shifting prohibition in the Act and must be rejected. 66 Pa. C.S. § 2804(7). Universal service costs were not allocated to classes based on this non-production demand allocator proposed by the OCA in PP&L's last base rate case. PP&L properly unbundled the universal service costs embedded in each customer class's rates. To change that allocation in any way is an impermissible cost shift under the Act. Id.

In allocating universal service cost recovery, PP&L has complied with the dictates of the Act and the Commission's Orders. Arguments to allocate universal service costs on a kWh basis or a non-production demand basis should be rejected by this Commission on the same rationale stated in the Universal Service Order; i.e., as violations of the just and reasonable requirement (66 Pa. C.S. § 1301), and as violations of the prohibition against cost shifting in (66 Pa. C.S. § 2804(7)).

E. FEDERAL/STATE JURISDICTIONAL DETERMINATION

PPLICA is not addressing this issue. PPLICA may respond, as appropriate, in a reply brief.

F. TRANSMISSION AND DISTRIBUTION UNBUNDLING

PP&L submitted tariff rate schedules that unbundled rates into the following three components:

(1) Delivery Charge; (2) Expected Market Price; and, (3) Residual CTC. PPLICA supports this preliminary unbundling, except for the inappropriate CTC levels caused by PP&L's flawed market price forecast. PPLICA Statement No. 1, p. 32. However, the delivery charges contained in PP&L's proposed tariff must be further unbundled into transmission and distribution components.

The Federal Energy Regulatory Commission's Order 888 ("FERC Order 888") required utilities to offer open access tariffs for the transmission of electricity through their lines. See FERC Order 888, 61 FR 21,540 (May 10, 1996). Larger PP&L customers can use this open access tariff to arrange for transmission of the purchased electricity into the PP&L distribution system. In the event the customer chooses to arrange for transmission itself, it should not be forced to pay to PP&L a rate that includes transmission service that is not being provided by PP&L. PPLICA Statement No. 1, pp. 33-34. A customer taking only distribution service from PP&L should be charged only a distribution charge. Id.

To rectify this situation, PPLICA witness Baron submitted worksheets detailing the further unbundling of transmission and distribution charges. PPLICA Statement No. 1, Exhibits SJB- 7 through 13. Baron used the same functional *distribution and* transmission revenue requirements developed by PP&L to calculate the recommended "delivery" charge in order to unbundle that delivery charge into separate transmission and distribution components. Id. at 33. It is important to note that because the transmission and distribution charges proposed by Baron in each instance add up to the delivery charge proposed by PP&L, this further unbundling only effects customers that arrange for their own

transmission. Id. In rebuttal testimony, PP&L supported the need to further unbundle transmission and distribution charges and supported the PPLICA approach. PP&L Statement No. 12R, Rebuttal Testimony of William H. Whitehead, p. 8. The Commission should accept the PPLICA unbundling of PP&L's rates into transmission and distribution components.

IX. PHASE-IN ISSUES

A. PHASE-IN SELECTION METHOD

One of the most important short-term issues in this proceeding is the determination of which customers will be given the opportunity to participate in the first two phases of direct access. The Act mandates that a maximum of 33% of the peak load of each customer class must have the opportunity for direct access on January 1, 1999, 66% must have the opportunity for direct access on January 1, 2000, and all customers must have the opportunity for access on January 1, 2001. 66 Pa. C.S. § 2806(b). As recognized by the Act, competitive disadvantages may be created by direct competitors in the same industry not both having access to the competitive market (and presumably cheaper electricity) at relatively the same time. 66 Pa.C.S. § 2806(b)(4).

PP&L proposes to have a subscription period prior to each specified date for determining which customers desire to participate. PP&L Statement No. 14, Direct Testimony of Henry W. Baumann, p. 4. In the event that any rate class is over-subscribed (that is more customers want to participate than there is eligible load) then PP&L would choose participants randomly from those indicating a desire to participate. PPLICA proposes an alternative method to handle phase-in that will lead to less competitive disadvantage situations. Subscription for each stage of phase-in will occur on a first come, first served basis unless a class is over-subscribed. In such event, each customer nominating a portion of load in the over-subscribed class will experience a pro-rata reduction in their nominated load, such

that the total load available for direct access in that class meets the Act's requirements. PPLICA Statement No. 1, pp. 58-59. The Commission adopted an identical proposal for the phase-in of industrial customers in the PECO service territory. PECO Restructuring Reconsideration Order, slip op. at 22.

The PPLICA method has two distinct advantages. First, the PPLICA method eliminates the possible competitive distortions that could occur if some industrial or commercial customers are permitted to participate in alternative access for their full load while other similarly situated customers may be denied participation because of the load cap. PPLICA Statement No. 1, pp. 58-59. Under the PPLICA proposal, all customers will have an equal percentage of load provided by a competitive supplier. Second, the PPLICA method maximizes the number of participants in the first two stages of phase-in. All customers that desire to participate in the first two stages and notify PP&L requesting to be included are assured that at least one-third of their load will be competitively provided on January 1, 1999, and at least two-thirds in the next stage.

To further eliminate any disproportionate effects of phase-in, PPLICA proposes that PP&L offer one-third of its load to direct access on January 1, 1999, the second one-third on January 2, 1999, and the final third on January 2, 2000. Id. This is clearly permissible under the Act. 66 Pa. C.S. § 2806(b). The Act establishes maximum participation targets for 1/1/1999, 1/1/2000, and 1/1/2001. The day after each target date, the next participation limit becomes effective. The Act does not establish a one-year period in which only the minimum amount of load can have direct access; rather, the Act simply establishes the next target and a maximum level that cannot be exceeded **on that date**. This accelerated phase-in was adopted by the Commission in the PECO restructuring proceeding in order to "provide the benefits of competition and complete the transition process as early as possible." PECO Restructuring Order, slip op. at 48. This interpretation of the Act is reasonable and is consistent with the goal of

maximizing customer access to the competitive market. The accelerated phase-in also eliminates many potential competitive disadvantage disputes. As explained by PPLICA witness Baron, two years is a lengthy period for an industrial customer to be denied access to the competitive generation supply market when its competitors have such access. PPLICA Statement No. 1S, p. 19. Shortening this period to one-year will lessen this negative effect and minimize competitive disadvantages. See PECO Restructuring Order, slip op. at 49. The Commission should again adopt the accelerated phase-in as the true and correct interpretation of Section 2806(b).

Both of PPLICA's phase-in proposals are designed to allow maximum participation during phase-in on terms that are fair to all customers. Both proposals should be accepted by the Commission.

B. GRANDFATHERING OF PILOT CUSTOMERS

Whether a particular pilot participant is grandfathered becomes irrelevant, under the PPLICA phase-in proposal. All customers are assured of at least 33% and 66% of their loads at the appropriate phase-in point, so grandfathering industrial pilot customers becomes a non-issue.

X. CODE OF CONDUCT AND COMPETITION ISSUES

PPLICA is not addressing the following sections: X.A; X.B; X.C.1, 2, and 4 through 6; X.D.1 through 5 and 7 through 9; X.E; X.F; X.G; X.H; X.I; and, X.J. PPLICA may respond, as appropriate, in a reply brief.

C. BASIS AND EXTENT OF PP&L'S PROPOSED CODE OF CONDUCT

3. Protection Of And Access To Customer Information

Customer information, including electricity usage, load profile and electricity price, must be subject to the utmost confidentiality constraints. For many electricity intensive industries, such information is highly proprietary and could reveal trade secrets or give competitors an undue

competitive advantage if revealed. Such information must be revealed only at the request of the customer and only to the parties authorized by the customer.

D. ADDITIONAL COMPETITIVE RESTRICTIONS PROPOSED

6. Prohibit Market Driven Contracts Before Choice Is Implemented

Certain parties in this proceeding have suggested that the Company should be prohibited from entering into contracts under the Company's currently effective Competitive Rate Rider ("CRR") tariff until retail access is permitted. Enron Statement No. 6.0, Direct Testimony of Michael D. Dirmeier, p. 11. This proposal is unreasonable, clearly violative of Chapter 28's express endorsement of special contracts, and may result in competitive disadvantages for larger customers. The proposal must consequently be rejected.

Chapter 28 expressly permits special contracts, "including negotiated, contract-based tariffs designed to meet the specific needs of a utility customer and to address competitive alternatives." 66 Pa. C.S. § 2806(h). The CRR is precisely this type of arrangement. The CRR purpose is as follows:

This experimental rider provides competitive rates to existing and new commercial and industrial customers served under Rate Schedules LP-5, LP-6, and IS-T who can demonstrate that they have a viable competitive alternative to purchasing electric service from the Company and intend to select that alternative to the detriment of the Company and its ratepayers.

PP&L Statement No. 11, Exhibit OGK 1, p. 19E. The CRR is clearly permissible and endorsed by the Act. 66 Pa. C.S. § 2806(h). The Commission must not force PP&L to cease offering a valid tariffed service to its customers based solely on some purported competitive disadvantage that alternative suppliers may experience if PP&L's options to enter into special contracts are not artificially limited.

In addition, it is unreasonable to force PP&L (and, more importantly PP&L's customers) to forgo the right to freely engage in arms length negotiations to achieve mutually agreeable contracts. Larger

customers are well aware of the contours of the upcoming competitive market. As explained by PPLICA witness Baron, "[i]f new CRR contracts are eliminated it would represent an additional reduction in the options and flexibility currently available to PP&L's industrial customers." PPLICA Statement No.1R, p. 14. If customers want to enter into a long-term contract with PP&L or any **alternate supplier**, then those contracts should be permitted.²⁷

Furthermore, prohibiting the negotiation of additional contracts may lead to competitive disadvantages. Some industrial customers are currently purchasing electricity through negotiated, long-term contracts (either through the CRR offered by PP&L or a similar provision on other utility systems). Id. Prohibiting other companies that have not yet entered into such contracts from attempting to obtain a comparable contract from PP&L extremely limits the competitive options available to businesses on the PP&L system. Id. This is inequitable given that it would have been reasonable for those businesses to assume that the CRR would remain an option because it is part of PP&L's current lawful tariff.

Enron's proposal to prohibit PP&L from entering into contracts under its currently effective CRR must be rejected. The Act specifically provides for the continued availability of these optional contracts to address special needs of customers with competitive alternatives. In addition, elimination of this option would harm customers by limiting their supply option in the period prior to and during the transition. The Commission mandated that PECO honor existing special contracts and be permitted to negotiate special contracts with customers not yet phased-in to customer choice. PECO Restructuring Order, slip op. at 119. The Enron proposal to limit PP&L's actions in this regard is inconsistent with Commission precedent, is not in the interests of customers and must be rejected.

²⁷It must be remembered that nothing prevents alternate suppliers from attempting to negotiate similar contracts before the beginning of retail access. PPLICA Statement No.1R, p. 13.

XI. CUSTOMER EDUCATION

PPLICA is not addressing this issue. PPLICA may respond, as appropriate, in a reply brief.

XII. UNIVERSAL SERVICE AND CUSTOMER ASSISTANCE PROGRAMS

PPLICA is not addressing the following sections: XII.A; XII.B; and XII.D. PPLICA may respond, as appropriate, in a reply brief.

C. ALLOCATION OF UNIVERSAL SERVICE PROGRAM COSTS

See Section VIII.D, supra.

XIII. ENVIRONMENTAL ISSUES

PPLICA is not addressing this issue. PPLICA may respond, as appropriate, in a reply brief.

XIV. CONCLUSION

The Commission is faced in this proceeding with critical decisions that will dictate the development of the competitive market for electric generation supply in Pennsylvania. The Commission must make these decisions with consideration of the central themes of Chapter 28 in mind; i.e., the economic goals of the Governor and General Assembly in enacting Chapter 28, and the need to balance the interests of ratepayers, shareholders, utilities and all market participants in deciding transitional issues. In addition, the Commission must consider the need for consistency in decisions on many issues for the utilities in a particular region and statewide. PPLICA has presented the best blueprint for the Commission to follow in maximizing the potential of the competitive market. PP&L and, to a lesser extent, other parties have presented proposals that are completely and utterly anti-thetical to the development of a competitive market and to enhancing the choices of customers during the transition period to pure competition. These proposals must be rejected.

A summary of the findings and conclusions necessary for the Commission to ensure that the envisioned competitive market develops is attached.

WHEREFORE, the PP&L Industrial Customer Alliance and the United States Department of Defense respectfully request that the Commission modify PP&L's electricity generation and customer choice plan consistent with the foregoing arguments.

Respectfully submitted,

McNEES, WALLACE & NURICK

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UNITED STATES DEPARTMENT OF DEFENSE &
FEDERAL EXECUTIVE AGENCIES

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Dated: February 12, 1998

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. The Commission adopts the three step process for the determination of the stranded costs to be recovered through PP&L's CTC; *i.e.*, claimability, quantification, and recoverability. Application of this methodology based on the PPLICA proposals in this proceeding values PP&L's stranded costs entitled to be recovered from ratepayers at \$694.638 million. (See, Section II.A, supra & Summary of Adjustments, Appendix C.)
2. Stranded costs must be shared between ratepayers and shareholders. The appropriate method for this sharing is the equity return disallowance applied to stranded generation costs. Based on the PPLICA quantification of properly claimable stranded costs for PP&L, the resulting decrease in recovery is \$47 million. (See, Section II.A, supra.)
3. The Commission adopts the Asset Value Method for the calculation of stranded generation costs. The Asset Value Method is the only calculation method contemplated by the Act, is consistent with the definition of stranded costs in the Act, and is the correct balancing of the interests of ratepayers and shareholders. Furthermore, the Commission utilized the Asset Value Method to determine stranded cost recovery for PECO. Because the level of recovery of stranded costs is a critical issue, the Commission must consistently apply the Asset Value Method on a state-wide basis. (See, Section III, supra.)
4. The Commission adopts the market price forecast performed by Randall Falkenberg on behalf of PPLICA in this proceeding. The PPLICA forecast is based on reasonable and verified input assumption, employs a model designed to predict future prices in a competitive market (as opposed to a regulated market), and produces plausible market prices that support the necessary addition of new capacity in the PJM region in the future. In the alternative, the Commission should adopt the OCA forecast as it did in the PECO restructuring proceeding. To ensure fair treatment for the ratepayers, utilities and competitors in the relevant geographic market for that forecast, the PJM region, all Commission decision with respect to market prices for PJM member utilities must use the same forecast. (See, Section IV, supra.)
5. The Commission rejects the market price forecast performed by Dr. Scott Jones on behalf of PP&L. First, Dr. Jones used unreasonable input assumptions designed to skew the forecast towards the low market prices that are necessary to manufacture stranded costs for PP&L in this proceeding. Most of the input assumptions are based on Dr. Jones' judgment and are not supported by other evidentiary sources. The Jones' market price forecast relies on a fuel price forecast he performed specifically for this proceeding. That fuel price forecast contains predictions obviously aimed at producing the desired low market price result. Second, Dr. Jones misapplied the EGEAS model in determining energy prices and failed to apply the model at all in his forecasting of capacity prices. The Commission cannot rely on one witness's independent judgment as to market prices especially when those ad hoc judgments conveniently create the scenario necessary for PP&L to claim larger stranded costs. Third, the market price forecasts presented by Dr. Jones are fundamentally flawed because the prices will not

support the addition of new capacity to meet the anticipated future demand of the region. The Jones forecast is obviously biased and must be rejected out of hand by the Commission. (See, Section IV, supra.)

6. The Commission adopts the PPLICA qualification of stranded generation-related costs based on application of the Asset Value Method of calculation and Mr. Falkenberg's projected market prices. Based on the PPLICA analysis, PP&L's stranded generation-related costs are \$798 million. (See, Sections III & IV, supra.)
7. The Commission rejects PP&L's claim for \$315.867 million in future fossil decommissioning expense recovery as contrary to established precedent. Future fossil decommissioning costs do not meet the "known and measurable" standard under Chapter 28. In addition, future fossil decommissioning costs were not traditionally recoverable in the regulated environment. (See, Section V.C.4, supra & Appendix G, infra.)
8. The Commission rejects PP&L's attempt to categorize any foregone recovery under the rate cap as a form of mitigation. Foregone recovery is clearly contemplated by the limits on the time and amount of recovery central to Chapter 28. Moreover, if PPLICA's stranded cost calculation is accepted (which it should be) the issue becomes moot as PP&L will clearly recover all allowed stranded costs within the transition period. (See, Section II.D.2.a, supra.)
9. Stranded costs must not be allocated to customer classes based on any allocation method except for the 12CP method endorsed in PP&L's 1995 base rate proceeding. PP&L has properly allocated stranded costs as an embedded portion of each rate class's bundled rates. *Changing this allocation will violate the cost shifting prohibitions in the Act.* (See, Section II.E, supra.)
10. The Commission recognizes a regulatory liability of \$55.588 million in the calculation of PP&L's total stranded costs to be recovered in this proceeding. The Company inappropriately requested recovery as regulatory assets for the following items: anticipated underrecovered energy costs in 1997 and 1998; employee transition costs; the Department of Energy assessment; and SSES deferred refueling costs. The Company failed to recognize regulatory liabilities for pension overfunding and post-retirement expense related to SFAS 106. In addition, the Company overstated the quantification of unrecovered energy costs at December 31, 1996. The net effect of these adjustments to the Company filing is recognition of a regulatory liability of \$55.588 million in the stranded cost calculation. (See, Section V.C, supra.)
11. The Commission adopts the fixed CTC design methodology for the recovery of PP&L's properly claimable and quantified stranded costs from ratepayers. This methodology establishes the CTC as a residual to the generation component of the bundled rate minus the expected market price for each year of the transition. The variable and levelized CTCs will inhibit the development of a competitive market and limit the ability of

customers to benefit from that market during the transition period and consequently must be rejected. (See, Section VII.A, supra.)

12. The Commission institutes the PPLICA proposed tracking mechanism to monitor PP&L's recovery of stranded costs through the CTC to insure that PP&L is not permitted to recover more than its properly claimable, quantified and recoverable stranded costs. (See, Section VII.C, supra.)
13. In the event that PP&L will not be able to recover its full stranded costs allowed for recovery during the transition period, an extension of the CTC recovery period may be appropriate. The Company must demonstrate the alleged underrecovery at that time; an automatic extension is not granted in this proceeding. In the event that the CTC recovery period is extended, the rate cap pursuant to Section 2804(4) must be extended concurrently in order to ensure that the captive ratepayers are not harmed. (See, Section VII.D, supra.)
14. The calculation of the CTC for interruptible customers that obtain electricity from competitive suppliers must be based on the interruptible CTC rates shown in the proposed tariff. Interruptible customers must not be subjected to a drastic increase in stranded cost responsibility by forcing those customers to revert to a firm rate schedule and CTC simply for accessing supply in the competitive market. The proposal is contrary to the central economic development goals of the Act, violates the rate cap, inhibits customer choice and must be rejected. (See, Section VII.F, supra.)
15. The Company's proposed Customized Rate Design is rejected. The proposal is unreasonable, violates the rate cap and anti-cost shifting provisions of the Act, and will further harm struggling businesses, contrary to the pro-business goals of the Act. In addition, the Company has failed to satisfy the burden of proving a reasonable basis for the Customized Rate Design. (See, Section VIII.A, supra.)
16. The Industrial Development Initiative and Economic Development Initiative must remain available throughout the transition period. Closure of the initiatives prior to the end of the transition violates the rate cap and anti-cost shifting provisions of the Act. (See, Section VIII.B, supra.)
17. PP&L's proposed modifications to the terms and conditions of its tariffs are rejected. No basis exists to require IST, ISP, ISA, PRS-1 and PRS-2 to take service only from the Company during the transition period. The changes to the frequency and duration of economic interruptions and the cost to buy through economic interruptions have no evidentiary support, are unreasonable, and are clearly anti-competitive. (See, Section VIII.C, supra.)
18. Universal service costs must be allocated to customers based on the allocations of uncollectibles expense in PP&L's last base rate proceeding. Alternative proposals to

allocate the costs on a kWh basis or on a non-production demand allocator violate the Act's prohibition against cost shifting (66 Pa. C.S. § 2804(7)) and the requirement that rates be just and reasonable (66 Pa. C.S. § 1301). The Commission must adhere to the precedent established in its Universal Service Order and the PECO restructuring decision by rejecting the alternative proposals. (See, Section VIII.D, supra.)

19. PP&L's proposed "delivery rate" must be further unbundled into "transmission" and "distribution" in order to ensure that customers able to arrange for transmission service under the FERC open access tariffs do not pay twice for transmission service. (See, Section VIII.F, supra.)
20. The PPLICA pro-rata, accelerated phase-in proposal is accepted. One third of the load in each rate class must have access to competitive supply on January 1, 1999, a second third must have access on January 2, 1999, and all customer load must have access on January 2, 2000. In addition, any oversubscription for the stages must result in a pro-rata reduction for each customer desiring participation. Both aspects of the proposal maximize participation in the competitive market and eliminate most potential competitive disadvantage claims. (See, Section IX, supra.)
21. PP&L is not prohibited from entering into contracts under its Competitive Rate Rider. This pricing option must remain open to customers in order to maximize customer choices. In addition, elimination of the CRR at this time may competitively disadvantage eligible customers that are not yet on a CRR contract. Furthermore, the Act specifically insures the continued availability of competitive options such as the CRR. (See, Section X.D.6, supra.)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission et al.)
vs. Pennsylvania Power & Light Co.)
Restructuring Plan) Docket No. R 00973954
)

APPENDIX To Large Power Consumer BRIEF
On behalf of consumer interest of
United States Department of Defense and
Federal Executive Agencies

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Of Counsel

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility)
Commission, et al.) Docket No. R 00973954
vs.)
Pennsylvania Power & Light Company)

**APPENDIX To Large Power Consumer BRIEF
On behalf of consumer interest of
United States Department of Defense and
Federal Executive Agencies**

In an effort to comply with directives of the Administrative Law Judge (ALJ) related to briefing, the consumer interest of the United States Department of Defense and Federal Executive Agencies (hereinafter collectively "DOD") tenders this Appendix to the Brief of Large Power Consumers, including members Pennsylvania Power & Light Industrial Consumer Alliance (PPLICA). Given constraints of those directives, PPLICA and DOD have worked together as best we could during the proceeding. As with the constraints imposed on cross-examination, the ALJ assigned DOD to this grouping over the exception and objection of DOD trial counsel made on the record.¹ This Appendix and Brief may reflect compromises among members of the large power Brief grouping. DOD appreciates the efforts and cooperation of PPLICA's lawyers, who were designated lead counsel by the ALJ, in this process.

Both being "consumer" interests, there are many areas of agreement between the positions of DOD and PPLICA. While PPLICA and DOD installations acquire their electric requirements on some of the same PP&L rate schedules, there are differences. Differing end uses for electricity dictate differences in interest in issues separating firm versus interruptible electric service. Likewise differences in load usage patterns dictate

¹ In this proceeding DOD counsel brought a ruling in United States v. Maryland P.S.C., 422 F.Supp. 676 (1976) to the attention of the ALJ. That argument of counsel is in the record and will not be repeated hear. The Order dated 30 April 1997, granted DOD's intervention petition, which stated DOD's interest could not adequately be represented by any other party. DOD intervention was pursuant to statutory authority, 40 U.S.C.A. § 486 (d). See also, United States v. Alaska P.U.C. 800 F.Supp. 857 (1992), aff'd 23 F3d 257 (1994).

other differences in issues of importance to DOD and PPLICA. That being said, the Appendix will focus on two limited areas of special concern to DOD, voiced in DOD Statement No. 1, Witness Thomas J. Prisco.² Areas of DOD concern may in part corroborate positions of some PPLICA witnesses. DOD also addresses issues not addressed elsewhere in the main PPLICA brief.

1. Fossil Plant Decommissioning

PP&L has sought to have the Commission authorize recovery through stranded costs decommissioning expenses of PP&L fossil fuel generating plant. In recommending this Commission reject this aspect of PP&L's proposal, DOD Witness Prisco said:

“...The Company (PP&L) has included roughly \$1 billion in fossil fuel” decommissioning in their calculation of stranded investment. At this time there is no reason to believe that exiting plants will not receive life extending upgrades in the deregulated market. Also there is not reason to believe that PP&L (or some third party) may not build future plants on th(e)s(e) same sites, given the difficulty sometimes incurred in siting all power plants....”³

In direct testimony Witness Prisco went on to point out that PP&L fossil fuel generating plants (and sites) may have a market value in excess of the proposed decommissioning costs. Allowance of speculative levels of decommissioning as a stranded investment in this proceeding is not appropriate. This Commission has rejected recovery by PP&L of this type of cost in the past. Re Pennsylvania Power and Light Company, Docket No. R 00943271, 85 P.U.C. 306, Order dated 27 September 1995 and ALJ decision at 1995 Pa. LEXIS 190 (entered 28 July 1995) citing Penn Sheraton Hotel v. Pennsylvania P.U.C., 198 Pa. Super. 618, 184 A2d 324 (1962). See also Re PECO Energy Company, Docket No. R 00973953, Slip Opinion, at 181 PUR4th 517 (entered 23 December 1997) footnote 96. Witness Prisco's testimony corroborates PPLICA's position on this issue in part in this brief, under **Section V. Revenue Under Regulation**, subsection C. (4).

² DOD Statement No. 1, direct testimony and exhibits of Thomas J. Prisco, was admitted into the record on 19 August 1997 at Transcript page 648.

³ DOD Statement No. 1, Prisco direct testimony page 10, lines 5 through 16.

2. Depreciation Swap

PP&L's proposal to swap a \$205 million difference between the current actual depreciation and theoretical accumulated depreciation for transmission and distribution transferring it to the accumulated depreciation associated with the Susquehanna generating plant should be rejected. DOD Witness Prisco said on direct:

"..PP&L's current rate payers have already paid the depreciation costs on the transmission and distribution system. Transferring the costs to mitigate stranded investment is unfair. This transfer will reduce the amount of stranded investment which exceeds the cap thus reducing shareholder exposure, while increasing the regulated transmission and distribution costs..."⁴

Definitional problems under the Uniform System of Accounts as to amounts transferred between generation and transmission accounts are obvious. Other regulators have not permitted such transfers between generation plant depreciation reserve and transmission accounts noting the anti-competitive problems. Consumers Power Company, Mich. PSC Case Nos. U-10685, U-10754, U-10787, 173 PUR4th 201, 225 (14 November 1996) noting the decision in F.E.R.C. Order No. 888, see 75 F.E.R.C. P61080 (24 April 1996). The amounts PP&L seeks to transfer between accounts are attributable to assets of very different character. Allowing such a transfer by PP&L would hardly be a good (or fair) regulatory accounting precedent.

In addition to the many valuable recommendations of PPLICA witnesses in this record, DOD requests that the Commission fully incorporated the recommendations of DOD Witness Prisco in its decision in this restructuring proceeding.

By



David A. McCormick
Attorney I.D. No. 17357

For The

United States Department of Defense and
Federal Executive Agencies

⁴ DOD Statement No. 1, Prisco direct testimony page 11, lines 3 through 13.

**Pennsylvania Power & Light Company
Summary of PPLICA Recommended
Stranded Costs**

(\$000)

	Company Claim ²	PPLICA Adjustments	PPLICA Recommendation/ Adjusted Amount ¹
Nuclear	\$2,873,041	(2,270,576)	\$602,465
Fossil	\$756,502	(1,117,563)	(\$361,061)
NUG	\$656,870	(100,566)	\$556,304
Regulatory Assets	\$354,326	(409,914)	(\$55,588)
Total Net Present Value (NPV) in 1999 \$	\$4,640,739	(3,898,619)	\$742,120

¹ PPLICA proposes an equity return disallowance on stranded generation cost which would reduce the Total Net Present Value in 1999 \$ by \$47,482,000 to \$694,638,000.

This disallowance is not reflected in these tables.

² Company Claim is based on Exhibit JRS 1A (Revised). PPLICA understands that PP&L has further revised its claim for Generation stranded costs, but this revision has not been reflected.

**Pennsylvania Power & Light Company
PPLICA Recommended Stranded Cost
Calculation - Nuclear**

(\$000)

	Company Claim ¹	PPLICA Adjustments	PPLICA Recommended/ Adjusted Amount
Revenue Required (1999)	723,356		n/a ²
Market Revenue (1999)	326,701	16,882	343,583
Total (Deficiency)/Excess (1999)	-396,655		n/a ²
PUC Jurisdictional Percent (1999)	87.34%	9.54%	96.88%
PUC (Deficiency)/Excess (1999)	-346,439		n/a ²
Summation of (Deficiency)/Excess Amounts (1999-2024)	-5,717,499		n/a ²
Discount Rate	7.92%		7.92%
Net Present Value (NPV) in 1999 \$	-2,873,041	2,270,576	-602,465

¹ Company Claim is based on Exhibit JRS 1A (Revised). PPLICA understands that PP&L has further revised its claim for Generation stranded costs, but this revision has not been reflected.

² PPLICA uses a margin approach in calculating stranded costs; therefore, there is no comparable value for PPLICA.

Pennsylvania Power & Light Company
PPLICA Recommended Stranded Cost
Calculation - Fossil
(\$000)

	Company Claim ¹	PPLICA Adjustments	PPLICA Recommended/ Adjusted Amount
Revenue Required (1999)	874,984		n/a ²
Market Revenue (1999)	665,700	142,672	808,372
Total (Deficiency)/Excess (1999)	-209,284		n/a ²
PUC Jurisdictional Percent (1999)	94.15%	2.73%	96.88%
PUC (Deficiency)/Excess (1999)	-197,041		n/a ²
Summation of (Deficiency)/Excess Amounts (1999-2024)	-1,123,985		n/a ²
Discount Rate	7.92%		7.92%
Net Present Value (NPV) in 1999 \$	-756,502	1,117,563	361,061

¹ Company Claim is based on Exhibit JRS 1A (Revised). PPLICA understands that PP&L has further revised its claim for Generation stranded costs, but this revision has not been reflected.

² PPLICA uses a margin approach in calculating stranded costs; therefore, there is no comparable value for PPLICA.

Pennsylvania Power & Light Company
PPLICA Recommended Stranded Cost Calculation
Non-Utility Generation
(\$000)

	Company Claim	PPLICA Adjustments	PPLICA Recommended/ Adjusted Amount
Cost of Purchase (1999)	168,576	-0	168,576
Market Value (1999)	63,901	5,463	69,364
Cost in Excess of Market Value (1999)	-104,676	5,463	-99,212
Less: Buy-out Payments (1999)	-20,732	0	-20,732
Total (Deficiency)/Excess (1999)	-125,408	5,463	-119,944
PUC Jurisdictional Percent (1999)	96.76%	0.24%	97.00%
PUC (Deficiency)/Excess (1999)	-121,345	4,998	-116,346
Summation of (Deficiency)/Excess Amounts (1999-2024)	-924,321	109,907	-814,414
Discount Rate	7.92%		7.92%
Net Present Value (NPV) in 1999 \$	-656,870	100,566	-556,304

Pennsylvania Power & Light Company
PPLICA Recommended Stranded Cost
Calculation - Regulatory Assets
(\$000)

	Company Claim ¹		Adjustments (NPV)	PPLICA Recommendation/ Adjusted Amount (NPV)
	Nominal Sum of Jurisdictional Amortizations 1999-2024 ¹	Jurisdictional Net Present Value @ 12/31/1998 (NPV) ²		
Unrecovered Energy Costs	80,150	76,815	-60,629	16,186
Post-Retirement Benefits	14,495	8,730	-53,990	-45,260
Susquehanna Operating Costs	12,836	9,830	0	9,830
Common Plant	18,220	7,783	0	7,783
Nuclear	17,896			
Other Production	324			
Retired Miners' Healthcare Costs	6,582	6,308	0	6,308
DOE Assessment	22,923	16,361	-16,361	0
Deferred Refueling Costs	8,343	7,996	-7,996	0
Voluntary Early Retirement Costs	15,190	14,085	0	14,085
Employee Transition Costs	22,279	17,106	-17,106	0
Rate Case Expenses	184	177	0	177
Taxes Recoverable	649,028	231,708	0	231,708
Nuclear	468,804			
Other Production	180,224			
Regulatory Liabilities				
Investment Tax Credit	-101,278	-42,573	0	-42,573
Nuclear	-73,425			
Other Production	-27,853			
Pension Over Funding	0	0	-253,832	-253,832
Total PUC Amortization (1999-2024)	748,952	-----	-----	-----
Net Present Value in 1999\$	-----	354,326	-409,914	-55,588

¹ Company Claim is based on Exhibit JRS 1A (Revised).

² See PPLICA Statement No. 3, p. 5; NPV of "Taxes Recoverable" was recomputed after PP&L adjustment to regulatory asset claim in Exhibit JRS 1A (Revised).

PPLICA Summary of Adjustments

	PPLICA		
	Company Claim	Adjusted Amount	Support in Record ⁽²⁾
Recoverable Regulatory Assets			
Unrecovered Energy Costs	76,815	16,186	St. 3, pp. 17-21; St. 3S pp. 19-23
Post-Retirement Benefits	8,730	-45,260	St. 3, pp. 26-29, Ex. LK-4; St. 3S, pp. 28-29
Susquehanna Operating Costs	9,830	9,830	PP&L Ex. JRS 1A (Revised)
Common Plant - Nuclear & Other	7,783	7,783	PP&L Ex. JRS 1A (Revised)
Retired Miners' Healthcare Costs	6,308	6,308	PP&L Ex. JRS 1A (Revised)
DOE Assessment	16,361	0	St. 3, pp. 24-25; St. 3S, pp. 28-29, Sur. Ex. LK-4
Deferred Refueling Costs	7,996	0	St. 3, pp. 36-37; St. 3S, p. 32
Voluntary Early Retirement Costs	14,085	14,085	PP&L Ex. JRS 1A (Revised)
Employee Transition Costs	17,106	0	St. 3, pp. 22-23; St. 3S, pp. 24-25
Rate Case Expenses	177	177	PP&L Ex. JRS 1A (Revised)
Taxes Recoverable - Nuclear & Other	231,708	231,708	PP&L Ex. JRS 1A (Revised)
Subtotal	396,899	240,817	
Offsetting Regulatory Liabilities			
Investment Tax Credit - Nuclear & Pension Over Funding	-42,573	-42,573	PP&L Ex. JRS 1A (Revised)
		-253,832	St. 3, pp. 14-16; St. 3S, pp. 15-18
Subtotal of Regulatory Assets and Liabilities	354,326	-55,588	
Non-Utility Generating Contracts	656,870	556,304	RJF-9a Revised
Nuclear Decommissioning Expense	n/a⁽³⁾	n/a⁽³⁾	
TOTAL Section 2808(c)(1) and (2) STRANDED COSTS	1,011,196	500,716	

PPLICA Summary of Adjustments

Utility Generation

Book Value	n/a ⁽⁴⁾	2,867,937	RJF-9a Revised ⁽⁵⁾
Less: Market Value	n/a ⁽⁴⁾	2,618,759	RJF-9a Revised
Stranded Cost	n/a ⁽⁶⁾	249,178	
Less: Non-jurisdictional amount	n/a ⁽⁶⁾	-7,774	RJF-9a Revised
Pa PUC Stranded Cost	3,313,676	241,404	
Fossil Decommissioning Expense	315,867 ⁽⁷⁾	0	St. 3, pp. 30-35; St. 3S, pp. 30-31
Other Transition Costs			
Disallowance	0	-47,482	SJB-2/SJB-3
TOTAL RECOVERABLE			
STRANDED COSTS	4,640,739	694,638	

- (1) Company Claim is based on Exhibit JRS 1A (Revised). PPLICA understands that PP&L has further revised its claim for Generation stranded costs, but this revision has not been reflected.
- (2) All references are to PPLICA Statements and Exhibits unless noted.
- (3) PP&L's Nuclear Decommissioning is embedded in the calculation of Stranded Generating Cost
PPLICA's Nuclear Decommissioning is embedded in the calculation of Market Value.
- (4) PP&L's calculation of Stranded Generating Cost uses a Revenue Requirements approach, and is therefore not directly comparable to PPLICA's use of the margin approach.
- (5) Book Value is the Total Book Value less Future Tax Depreciation Benefits, Accumulated Deferred Income Tax Credit Benefits and Deferred Income Tax from Exhibit RJF-9a- Revised
- (6) PP&L did not calculate stranded costs on a total company basis.
- (7) Calculated based on Exhibit JRS 1A (Revised) using PP&L methodology for NPV and revenue requirements. See Appendix G, *infra*.

**STATEMENTS AND EXHIBITS OF
LARGE CUSTOMER GROUP**

STATEMENT/EXHIBIT NO.	DESCRIPTION	DATE ADMITTED
PPLICA Statement No. 1	Direct Testimony of Stephen J. Baron	8/26/97
PPLICA Exhibit SJB-1	Expert Testimony Appearances of Stephen J. Baron	8/26/97
PPLICA Exhibit SJB-2	PPLICA Recommended Stranded Costs	8/26/97
PPLICA Exhibit SJB-3	PPLICA Stranded Generation Sharing Analysis	8/26/97
PPLICA Exhibit SJB-4	PP&L Calculation of Adjusted Rate of Return	8/26/97
PPLICA Exhibit SJB-5	Summary of CTC Tracking Mechanism	8/26/97
PPLICA Exhibit SJB-6	PPLICA Load-Weighted Market Prices	8/26/97
PPLICA Exhibit SJB-7	Unbundling Analysis — Rate RS	8/26/97
PPLICA Exhibit SJB-8	Unbundling Analysis — Rate LP-5	8/26/97
PPLICA Exhibit SJB-9	Unbundling Analysis — Rate LP-4	8/26/97
PPLICA Exhibit SJB-10	Unbundling Analysis — Rate LP-6	8/26/97
PPLICA Exhibit SJB-11	Unbundling Analysis — Rate IS-T	8/26/97
PPLICA Exhibit SJB-12	Unbundling Analysis — Rate IS-P	8/26/97
PPLICA Exhibit SJB-13	Unbundling Analysis — Rate ISA	8/26/97
PPLICA Statement No. 1R	Rebuttal Testimony of Stephen J. Baron	8/26/97
PPLICA Statement No. 1S	Surrebuttal Testimony of Stephen J. Baron	8/26/97
PPLICA Statement No. 2	Direct Testimony of Randall J. Falkenberg	8/26/97
PPLICA Exhibit RJF-1	Qualifications of Randall J. Falkenberg	8/26/97
PPLICA Exhibit RJF-2	Fuel Price Forecast Comparison	8/26/97
PPLICA Exhibit RJF-3	Expected Value of PJM Market Closing Price	8/26/97
PPLICA Exhibit RJF-4	Production Cost Model Studies and Benchmarks to Utility Company Models Used in Regulatory Proceedings	8/26/97
PPLICA Exhibit RJF-5	Comparison of Market Price Model Results K & A Model vs. MAPS, IPM, PMDAM	8/26/97
PPLICA Exhibit RJF-6	Combined Cycle Plant Heat Rate vs. Capital Cost	8/26/97
PPLICA Exhibit RJF-7	Annual Revenue Requirements	8/26/97
PPLICA Exhibit RJF-8a	PP&L Stranded Cost Summary	8/26/97
PPLICA Exhibit RJF-8b	PP&L Calculation of Net Present Value of Contribution Margins	8/26/97
PPLICA Exhibit RJF-8c	PP&L Annual Total	8/26/97
PPLICA Statement 2S	Surrebuttal Testimony of Randall J. Falkenberg	8/26/97
PPLICA Exhibit RJF-9a	PP&L Stranded Cost Summary	8/26/97
PPLICA Exhibit RJF-9b	PP&L Calculation of Net Present Value of Contribution Margins	8/26/97
PPLICA Exhibit RJF-9c	PP&L Annual Summary	8/26/97
PPLICA Exhibit RJF-10	PP&L Response to PPLICA Interrogatory VII.1	8/26/97
PPLICA Exhibit RJF-11a	Corrected STJ Capacity Per EGEAS Run	8/26/97

PPLICA Exhibit RJF-11b	Corrected STJ Capacity Per Adjusted EGEAS Run	8/26/97
PPLICA Exhibit RJF-12	"Keep in Mind the Difference between LHV and HHV in making fuel calculations"	8/26/97
PPLICA Exhibit RJF-13a	Correction of STJ 28 Based on EGEAS CC Capacity	8/26/97
PPLICA Exhibit RJF13-b	Correction of STJ 28 Based on Current CC Models	8/26/97
PPLICA Exhibit RJF-14	Benchmarks of EGEAS to Kennedy and Associates Models Cancellation of Trimble County vs. Completion of Baseload Forecast; Present Worth Revenue Requirements: 1984-2023	8/26/97
PPLICA Exhibit RJF-15	PECO & PP&L Model for Marginal Units	8/26/97
PPLICA Statement 2S (Update 8/22/97)	Surrebuttal Testimony of Randall J. Falkenberg	8/26/97
PPLICA Exhibit 9a-R	PP&L Stranded Cost Summary	8/26/97
PPLICA Exhibit 9b-R	PP&L Calculation of Net Present Value of Contribution Margins	8/26/97
PPLICA Exhibit 9c-R	PP&L Annual Total	8/26/97
PPLICA Exhibit RJF-11A-R (Revised)	Corrected STJ Capacity Per EGEAS Run Revised	9/09/97
PPLICA Exhibit RJF-11B-R (Revised)	Corrected STJ Capacity Per Adjusted EGEAS Run Revised	9/09/97
PPLICA Statement No. 3	Direct Testimony of Lane Kollen	8/25/97
PPLICA Exhibit LK-1	Curriculum Vitae of Lane Kollen	8/25/97
PPLICA Exhibit LK-2	PP&L Response to Interrogatory OCA I-7	8/25/97
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PPLICA Exhibit LK-4	SFAS 106 Regulatory Liability	8/25/97
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PPLICA Exhibit Surrebuttal LK-3	Corrected Version of Schadt Rebuttal Testimony Example	8/25/97
PPLICA Exhibit Surrebuttal LK-4	PP&L Response to Interrogatory PPLICA II-10	8/25/97
PPLICA Statement No. 4	Direct Testimony of James H. Rooney	8/19/97
PPLICA Statement No. 5	Direct Testimony of James S. Schneider	8/19/97
DOD Statement 1	Direct Testimony of Thomas J. Prisco	8/19/97

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PENNSYLVANIA PUBLIC UTILITY COMMISSION
OFFICE OF CONSUMER ADVOCATE, ET. AL.

V.
PECO ENERGY COMPANY

PUBLIC MEETING -
MAY 8, 1997
MAY-97-OSA-159*
DOCKET NO. R-00973877

STATEMENT OF COMMISSIONER JOHN HANGER

I. INTRODUCTION

Today the Commission starts to determine how much rates will go down for the customers of PECO Energy Company during the transition period from electric monopolies to full electric competition that is required by the Electricity Generation Customer Choice and Competition Act ("Act"). Held in Philadelphia, Norristown, and Media, this case's Public Input hearings frame well this Commission's responsibility and the debate that this Commission must adjudicate as the Commission determines how much PECO's rates will decline during the transition period. Many witnesses complained about the high rates of electricity currently charged by PECO Energy and urged that stranded cost recovery not be allowed to devour the price reduction that competition offers. Still other witnesses at those same hearings pleaded that this Commission should allow PECO Energy to recover all of PECO's alleged \$6.8 billion of stranded costs in uneconomic plants in order to protect their investment in PECO. As the public input witnesses clearly understood, an inescapable relationship exists between the amount of stranded investment recovery allowed and the amount of rate decreases that will be possible during the transition period.

My responsibility in this case and the other electric restructuring proceeding is to resolve fairly these conflicting pleas from businesses and poor families hurt by high electric rates and pensioners and utility investors who are threatened by competition. I shall meet this responsibility by faithfully implementing the Electricity Generation Customer Choice and Competition Act ("Act") and exercising judgment in a manner that balances the interests of utility shareholders, consumers, and new entrants into Pennsylvania's retail electric market. If I am successful in finding the right balance, no party will get all that it wants and all parties may dislike the outcome.

As I listened to the public input witnesses, I was struck by the fact that the witnesses were passionately arguing about a rate decrease. The fight was and is over how much the rate decrease should be. PECO says it should be 3.4%. Others say that is much too little when approximately a 40% decrease is possible.

The Electricity Generation Customer Choice and Competition Act ("Act") has already changed the debate at the Commission from arguments about rate hikes to battles about rate cuts. Is that not progress?

All should remember that a few months ago, when generation monopolies were the law of the land, this Commission's task was deciding the furious battles waged by consumer advocates and electric utilities about whether rates should go up by 5% or 10% or some higher or lesser amount. When the rate battles ended, the result was always a rate hike and sometimes a rate shock.

In just the four years prior to the Act, this Commission decided 6 electric rate cases involving four of Pennsylvania's electric utilities. All 6 rate cases were base rate increase cases. In all 6 cases consumer representatives and public utilities fought about how much electric rates should go up. A rate hike was a foregone conclusion. All 6 cases ended with the Commission approving annual rate increases of up to \$107 million.

Fortunately, the Act means that this Commission must rewrite the electric regulation book. The decision on PECO's Petition and the important Tentative Order establishing pilot programs are early chapters in a long book that is a work in progress. For PECO Energy and its customers, the most important chapters will not be reached until the Commission decides in December PECO's restructuring filing. Only then will it be known how much rates will decrease and how much stranded investment will be recovered.

Through its Petition PECO seeks to securitize now approximately 68% of its stranded generating plant and 50% of its stranded regulatory assets. PECO's Petition to securitize \$3.773 billion should be denied.

PECO should alternatively be permitted to securitize at this point approximately \$1.1 billion. This amount in the allocations specified below would allow PECO to securitize now 16% of its total stranded generating claim of \$3.566 billion and 14% of its stranded regulatory asset claim of \$2.636 billion

Today's decision is just one of many difficult decisions that the Commission must make as it implements the Act. As someone who urged early and often that Pennsylvania should repeal its electric monopoly laws and begin as soon as possible the transition process to full electric competition, I welcome today's difficult decision as well as the ones ahead. I do so because Pennsylvania will be a better place in which to do business and to raise a family at the end of the process.

II. STATEMENT OF THE CASE

The contradictory facts and arguments about PECO Energy's Petition to securitize \$3.773 billion creates a litigation fog that may obscure what this case is about. To lift the fog a little, some questions must be answered. Questions like will this case increase rates for PECO's customers? How could this case not raise rates when PECO Energy petitions this Commission to recover a total of \$6.8 billion of alleged stranded investment and to securitize now \$3.77 billion? And what is stranded investment if it is not a rate hike?

To take the last question first, stranded investments are past costs that PECO and other electric utilities incurred mainly for generation plants that today generate electricity at prices above the competitive market price for electricity. The stranded investment that PECO seeks to recover in this case is already in the rates that customers are paying each month. PECO seeks to keep charging customers for the stranded investment that is now in rates during the transition to full competition that could take as long as 10 years to finish completely. For that reason, the decision in this case will not raise rates for any customer of PECO Energy.

In fact, including PECO Energy, every party offers positions that would cut PECO's electric rates in some amount during the transition. For example, PECO's proposal to recover and securitize \$3.6 billion of its total stranded investment would cut electric rates by 3.4% or \$111 million per year.

Many intervenors, however, argue that PECO's proposed rate cut is too small. These parties note that rate decreases to consumers would be much greater if the Commission disallows some or all of PECO's stranded investment claim than if it allows recovery and securitization of all of PECO's stranded investment.

During the transition period to full competition that could last as long as 10 years, there is an inescapable relationship between the amount of stranded investment recovery and the amount of rate decreases. More stranded investment recovery translates into smaller rate decreases. If PECO recovers 100% of its total stranded investment and that stranded investment is securitized, PECO's rates would decrease by approximately 5% during the transition. If all stranded investment was removed from PECO's present rates, rates would fall by approximately 40%.

Consequently, no matter how this Commission implements the Act, the rates for PECO's customers are coming down, even during the transition period. Once the transition period is completed, customers will receive the full price benefits of competition and any future stranded investment will be the sole responsibility of shareholders.

III. POSITION OF THE PARTIES

The parties to this case should be commended for their hard work and zealous advocacy of their interests. Additionally, I thank those people who attended the public input hearings and provided a wide range of opinions and thoughts. The public input hearings sharpen and put a face on what is at stake in a fashion that the experts never do. To me, that contributes to the deliberative process.

A. Position Of PECO Energy

Compared to a total of \$6.8 billion of stranded investment that PECO claims it has in its restructuring filing at Docket R-00973953, PECO wants the Commission to authorize the securitization of \$3.773 billion of expenses. Those expenses include \$1.16 billion of stranded regulatory assets and \$2.44 of stranded generation plant or a total of \$3.6 billion of stranded investment.

Again PECO asserts the refinancing savings that securitization of all \$3.6 billion would produce a rate cut of \$111 million or a 3.4% reduction for ratepayers.

PECO argues that it met its burden of proving by the preponderance of the evidence and with substantial evidence that its Petition is just and reasonable and in the public interest. PECO Main Brief, p.1.

PECO also asserts that denial of stranded investment recovery would constitute an unconstitutional taking of its property. Id. at 16. PECO further argues that the mandatory access to its transmission and distribution facilities is also an unconstitutional per se taking of its property. Id. at 18. Since both FERC Order 888 and the Electricity Generation Customer Choice and Competition Act mandate access to PECO's transmission and distribution system, this latter argument if successful could void the Act and wholesale electric competition.

B. Position Of Intervenors

In this case, the parties opposing PECO's petition to securitize \$3.6 billion do so, because they wish to argue in the restructuring filing that will be decided in December for a larger rate decrease than the 3.4% now offered by PECO. Consequently, they want to preserve their ability to contest PECO's estimate of the amount of stranded investment and to argue that some or all of PECO's stranded investment should be disallowed in its restructuring proceeding. Securitization and refinancing of the \$3.6 billion now would make it impossible for these parties to present a case for disallowance of that amount.

Those opposing PECO's Petition offer a variety of positions. One group argues that PECO's Petition should be denied completely. Included in this group are IPALCO, the Environmentalists, CEPA, and Senator Fumo.

Those arguing for complete denial of PECO's Petition offer largely legal arguments in support of their position. They generally do not make specific, factual adjustments to PECO's Petition.

The legal attacks made on PECO's Petition include anti-trust, statutory interpretation, and constitutional arguments. As pressed here, some of the constitutional claims could invalidate substantial portions of the Act, particularly those sections of the Act that deal with recovery of stranded investment.

While making legal challenges to PECO's Petition, a second group of intervenors challenge the evidentiary and factual basis of the Petition. Included in this group are the Office of Consumer Advocate (OCA), the Office of Trial Staff (OTS), the Philadelphia Area Industrial Energy Users Group (PAIEUG). These parties make adjustments to PECO's stranded investment claim that could warrant denying a lot of but not all of PECO's Petition.

Of the total of \$3.773 billion that PECO seeks to securitize, OCA allows securitization of \$514 million; Enron supports the OCA position; Pennsylvania Power and Light argues only those stranded cost claims that are "beyond controversy;" PAIEUG recommends securitization of \$1.08 billion; and OTS permits securitization of \$1.6 billion.

IV. POSITION OF THE ADMINISTRATIVE LAW JUDGE

After hearing the arguments of PECO and all those opposing PECO's Petition, the Administrative Law Judge offers a primary and a secondary recommendation. His preferred outcome is that PECO's Petition be denied in its entirety on the procedural and legal ground that PECO's Petition sought recovery of so much stranded investment that the issues raised by the Petition could not be fairly litigated in the statutory period of 120 days. Recommended Decision, p.14. The ALJ's alternative recommendation is that PECO be allowed to securitize \$321 million of regulatory assets.

V. THE ALJ'S DISMISSAL OF THE PETITION ON LEGAL GROUNDS IS ERRONEOUS

PECO's Petition cannot be denied as a matter of law. The statute clearly states that petitions for expedited securitization may be filed. The statute does not limit the amount of securitization for

which the utility may seek expedited review. The statute just as plainly directs that the Commission must render a decision within 120 days of the date of a petition's filing.

The Administrative Law Judge agrees that PECO has the statutory right to file this Petition and decide how much to Petition. R.D.at 11. Yet, the ALJ says that the expedited securitization process should be used for the most "uncontroversial of financial transactions." Id.

For the sake of argument, let us make the rather shaky assumption that there is a stranded investment claim that is uncontroversial. Assuming that PECO could have made an uncontroversial filing, the legal question becomes, does the Act contain any requirement that the expedited securitization process be limited to claims that are not controversial?

My repeated reading of the relevant sections of the Act--66 Pa. C.S. Sections 2812(A)(2)(II) and 2812(B)(1)(I), (II), and (III)-- confirms that there is no such limitation in the Act. Though some parties wish it were otherwise, the law does not support their wishes.

The ALJ further argues that PECO's failure to limit its Petition to "uncontroversial" claims for stranded investment creates a complex case that cannot be resolved consistent with the general statutory mandate that the transition to competition must be fair to ratepayers. 66 Pa.C.S. Section 2804(14). He, therefore, denies PECO's Petition entirely. He does so, even though the Act does not require that the expedited process be limited to controversial stranded investment claims, assuming that such things exist. He does so, even though he agrees that PECO had a statutory right to file its Petition and a statutory right to decide on the amount of its request. He does so, even though he agrees that PECO met all the legal requirements of Section 2812. In order to comply with the statutory mandate that the transition to competition must be fair to ratepayers, it is not necessary or permissible to be unfair to public utilities by flatly denying Petitions that meet all applicable legal requirements.

The right means of insuring that the transition to competition is fair to ratepayers is to require public utilities to meet their burden of proof, to carefully review factual records, and to balance the interests of shareholders and ratepayers, In this case, the record contains many factual challenges to PECO's Petition.

VI. STANDARDS FOR DECISION

As a proponent of this Petition, PECO has the burden of proof. It must demonstrate that the preponderance of the evidence supports its Petition for securitization of \$3.77 billion of expenses. In turn, the Commission's findings and conclusions must be supported by substantial evidence in the record.

The Act further requires that any amount of stranded investment that is allowed for recovery must be (1) known and measurable; (2) net present value calculation; (3) just and reasonable; and (4) in the public interest. PECO also has the burden of proof to establish that its Petition meets these statutory standards

The Act establishes different standards for stranded investment recovery depending on whether the stranded investment at issue is a regulatory asset or generation plant investment. If stranded investment results from regulatory assets or PURPA contracts, the Act requires the Commission to allow recovery of that amount that is known and measurable and calculated on a net, present value basis amount.

If the stranded investment claim involves generation plant investment, the Act requires the Commission to conduct a two-step analysis. First, the Commission must determine how much of the claim is known and measurable and to calculate the amount on a net, present value basis. Once the Commission identifies an amount of stranded generation plant that is known and measurable and calculated on a net, present value basis, the Act requires the Commission to decide how much of that total would be "just and reasonable" to allow shareholders to recover.

So what does "just and reasonable" mean? The Act does not provide a definition of the term. Consequently, I rely on the plain meaning of those words as well as the traditional regulatory meaning of the phrase "just and reasonable."

The term just and reasonable has been a cornerstone of traditional ratemaking and jurisprudence. In Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Co., 424 A.2d 1213 (1980), the Pennsylvania Supreme Court said: "...the term 'just and reasonable' was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices charged to utility consumers and returns on capital to utility investors consonant with constitutional protections applicable to both." *Id.* at 1219. See also Pennsylvania Electric Company v. Pennsylvania Public Utility Commission, 502 A.2d 130, 133 (1985).

In the context of the Act that requires this Commission to define the terms of a transition to a competitive generation market, the essence of the meaning of "just and reasonable" is the balancing of the interests of shareholders, ratepayers, and new entrants to the market.

VII. PECO'S STRANDED GENERATING PLANT CLAIM

PECO alleges that it has a total of \$3.566 billion of stranded generating plant. Of that total, it petitions to securitize now \$2.435158 billion or 68% of its total stranded generating plant claim. PECO's principal evidentiary support for its claim consists of three different market price studies that use computer modeling to predict the future market price for generation over the forecast period. The EDS, ICF, and PHB studies respectively predict a 1999 market price of 2.92, 2.77, 2.42 cents per kilowatt-hour and net stranded generating plant owned by PECO of \$3.33 billion, \$3.47 billion, and \$3.89 billion respectively. An average of its three market price studies produces a 2.70 cents per kilowatt-hour.

The intervenors, especially OCA and PAIEUG, make numerous factual challenges to the assumptions that are the foundation of PECO's market price studies and its stranded generating claim. The intervenors argue that PECO's stranded generating claim rests on inadequately supported or erroneous judgments about the: 1) appropriate reserve requirement for reliability planning; 2) future prices of fossil fuels; 3) the capacity factor for PECO's nuclear units; 4) heat rates and capacity charges of new generation projects; 5) type of generation that will be employed when capacity in PJM is needed; 6) date that capacity will be needed in PJM; 7) amount and affect of imports into PJM; 8) impact of transmission congestion on the value of PECO's generation; 9) jurisdictional allocation of a portion of PECO's generation between wholesale and retail customers; 10) treatment and status of the Salem nuclear generating station; 11) going-forward costs of PECO's generation portfolio; 12) modeling and treatment of no-load & startup costs for marginal generation; 13) internal consistencies in PECO's generation valuation models; 14) discount rate for presenting stranded generation on a net present value basis; 15) role of the retail access phase-in in calculating stranded generation; and 16) use of wholesale as opposed to retail prices in calculating the value of PECO's generation.

While not all of these evidentiary challenges are meritorious, enough are convincing to conclude that PECO has not met its burden of proof that its stranded generating plant claim of \$2.435 billion is known and measurable, just and reasonable, and in the public interest.

OCA offers 7 specific adjustments to PECO's stranded generating plant claim that total \$2.771 billion. They are: 1) fuel price increase of 10% for a \$586 million adjustment; 2) cost reduction of 10% for a \$566 million adjustment; 3) nuclear capacity based on 1992-1996 actual data for \$643 million; 4) regional capacity need in 1999 for \$197 million; 5) PHB capacity price with EDS energy price for \$435 million; 6) half-year net present value convention for \$86 million; and 7) 1% discount rate decrease for \$258 million. OCA Main Brief at 31.

With the exception of the inadequately supported assumption of a 10% cost reduction and a fuel price increase of 10% beyond the EDS fuel projection, OCA's adjustments raise substantial questions about \$1.619 billion of PECO's stranded generation claim. At least those \$1.619 billion worth of questions should be finally resolved in PECO's restructuring proceeding.

It would not be just and reasonable or in the public interest to securitize now any part of that \$1.619 billion of stranded generating claim that is not on this record known and measurable. Conversely, after subtracting \$1.619 billion from PECO's Petition to securitize \$2.435 billion, \$816 million of stranded generating plant is left as known and measurable.

PAIEUG also submitted a comprehensive evidentiary challenge to PECO's stranded generating plant claim of \$2.435 billion. PAIEUG recommends that \$1.828 billion be denied. PAIEUG's case supports securitization of \$607 million of stranded generating plant.

PAIEUG's specific adjustments include: 1) using nuclear capacity based on 1992-1996 actual data; 2) using a 7.77% after tax discount rate; 3) using estimated long run marginal cost of generation based on base load combined-cycle plant; 4) changing the EDS assumption of no inflation increases to the cost of new capacity; and 5) omission of the shut-down salem nuclear plant.

PAIEUG's adjustments also raise substantial questions that preclude a finding now that PECO's claim of \$2.435 billion is known and measurable. Additionally PAIEUG's case makes it unreasonable to find that this record justifies a finding that securitization of more than \$607 million of stranded generating plant would be just and reasonable and in the public interest.

Given the irrevocable nature of a Qualified Rate Order and the marginally superior evidentiary quality of the PAIEUG adjustments, the PAIEUG recommendation should be accepted. Allowing PECO to securitize now 16% of its stranded generation claim is just and reasonable and in the public interest.

VIII. REGULATORY ASSETS AND DEFERRED FUEL CHARGES

The Electricity Generation Customer Choice and Competition Act requires recovery of stranded regulatory assets that are known and measurable, that are presented on a net present value basis, and that are stranded on a net basis, and that will remain following mitigation by the electric utility. 66 Pa.C.S. Sections 2803 and 2808(c)(1).

PECO asks the Commission to allow it to recover \$1.164842 in regulatory assets and deferred costs. Numerous objections to PECO's claim were raised by the intervenors.

The record requires acceptance of OCA's position on stranded regulatory assets as modified to reflect the December 31, 1998 estimated balance of the approved assets. OCA recommends securitization of \$514 million of regulatory assets and deferred fuel expenses. As modified to reflect the balance of these assets and charges on December 31, 1998, \$469 million should be approved for securitization.

OCA's list of regulatory assets that should be securitized includes the following: 1) Unamortized Loss on Reacquired Debt; 2) Deferred Undercollection of Fuel Costs for the period February 1, 1996 to December 31, 1996; 3) Carrying Charges and Deferred Depreciation on 50% of Limerick Common; and 4) Carrying Charges and Deferred Depreciation on 50% of Eddystone/Peach Bottom/Salem Common Plant. These items are in rates already at a significantly higher cost of capital than PECO's estimated securitized debt rates. To not securitize these amounts would make ratepayers to continue to pay more than is necessary.

A. Unamortized Loss on Reacquired Debt

PECO has on its balance sheet as a regulatory asset tender and call premiums incurred by PECO to reacquire high cost debt. The Commission has allowed PECO both a return-of and a return-on such premiums to encourage economic refinancing of high coupon debt.

PECO amortizes these premiums over the life of the new, lower coupon debt issuance and adjusts its debt cost rates and capital structure ratios so as to allow for a return on the unamortized balance of such premiums at the average coupon rate. Securitizing this regulatory asset, in the amount of \$179.7 million as of December 31, 1998, will produce ratepayer savings in the near term as well as over the life of the asset.

B. Deferred Undercollection of Fuel Costs for the period February 1, 1996 to December 31, 1996

PECO has sought recovery of deferred fuel costs associated with the elimination of its Energy Cost Adjustment (ECA) in December of 1996. This represents the Company's actual undercollected energy costs from February 1, 1996 to December 31, 1996, including its earned nuclear performance bonus for calendar year 1996.

In its Tentative Order of December 19, 1996, the Commission granted the Company authority to defer these costs at an interest rate of 9%. Petition of PECO Energy, Docket Nos. P-961128, R-963838 (Tentative Order of Dec. 19, 1996). The amount of this deferral including the earned nuclear performance bonus and including interest is \$96 million. These costs represent actual costs expended by the Company during its last ECA period.

This item is known, measurable and certain in amount. The recovery of these costs at the securitized interest rate of approximately 7.42% rather than the Commission authorized interest rate of 9% will provide savings to customers over the period of recovery of these costs. It will also avoid a \$96 million fuel cost rate increase that would have been required under the Public Utility Code before its amendment by passage of the Electricity Generation Customer Choice and Competition Act.

PECO also claims another \$143.3 million of future fuel costs that have yet to be incurred. This portion of PECO's fuel cost claim is potentially duplicative of other claims, speculative, and unpersuasive.

C. Carrying Charges and Deferred Depreciation on 50% of Limerick Common

The Limerick Nuclear Plant consists of two nuclear generating units that utilize common facilities. At the time Limerick 1 was included in PECO's rate base in 1986, only 50% of the costs associated with the common plant were included in rates. At that time, PECO was allowed to defer the

carrying charges and depreciation expense associated with the remaining common plant that was completed and in-service but not reflected in rates.

In PECO's 1990 base rate case where PECO sought inclusion of Limerick 2 in rates, including the remaining 50% of common plant, PECO requested recognition in rates of the deferred carrying charges and depreciation expenses associated with that common plant. PECO was permitted to amortize these deferrals, with a

return on the unamortized balance, over the life of Limerick 2. In its 1996 accounting order, the Commission authorized PECO to accelerate this amortization for accounting purposes. This regulatory asset, in an amount of \$175.8 million as of December 31, 1998, is a reasonable candidate for securitization in this proceeding. This cost is already reflected in rates and securitization will result in ratepayer savings both initially and over the remaining amortization period.

D. Carrying Charges and Deferred Depreciation on 50% of Eddystone/Peach Bottom/Salem Generating Stations

The Eddystone, Peach Bottom and Salem generating stations, like Limerick, consist of multiple units which utilize common facilities. As with Limerick, the Commission allowed 50% of these common costs to be reflected in rates when the first unit was allowed in rate base and permitted PECO to defer carrying charges and depreciation expense associated with the remaining 50% of common facilities until such time as the remaining units were completed and reflected in rates.

When the second unit was reflected in rates, the Commission allowed amortization of these deferred common facility costs for each station. These costs, \$17.4 million as of December 31, 1998, are already reflected in rates and securitization will result in rate savings to ratepayers in both the initial years and over the life of the amortization.

E. Regulatory Assets That Should Not Be Securitized In This Decision

The remaining regulatory assets for which PECO petitions to be securitized should be deferred to PECO's restructuring proceeding, where the controversies and factual issues presented by PECO's request for recovery of these assets can be resolved.

1. Limerick 1 and 2 Early Window Costs.

Limerick Early Window Costs are deferred costs related to carrying costs (return and taxes) depreciation, and O&M expenses associated with Limerick 1 and 2, net of fuel savings. First, since there is no return component or interest on these assets, there will be a net lifetime cost associated with securitization due to the additional interest expense associated with the transition bonds.

2. FAS 106 Obligation Associated with VRIP and VSIP.

SFAS 106 required PECO to recognize in its present financial statements the expenses associated with the provision of other post-employment benefits (OPEBs) to retired employees. FAS 106 mandated the use of the accrual method of accounting for OPEBs which increased the amount of expenses to be recognized in the financial reports. In 1996, PECO was allowed to increase its rates by \$25 million to fully fund the SFAS 106 obligations, including its transition obligation.

In this case, PECO claimed as a regulatory asset the unamortized portion of the deferred SFAS 106. In addition, in 1994, the Company initiated a Voluntary Retirement and Separation Incentive Program (VRIP and VSIP) that was accepted by a number of employees. Under GAAP, PECO was required to recognize as an expense, in the year of retirement or separation, the entire transition obligation for these employees.

Deferred SFAS 106 costs should not be securitized in this proceeding for two reasons. First, since there is no return component or interest on these assets, there will be a net lifetime cost associated with securitization due to the additional interest expense associated with the transition bonds. Securitization would result in increased lifetime costs to ratepayers rather than reduced costs to ratepayers as contemplated by the legislation. Second, for the SFAS 106 obligation associated with VRIP and VSIP, the reasonableness of the costs of these programs has not been previously reviewed by the Commission.

In the restructuring case, the Commission must assure itself that the VRIP and VSIP costs are reasonable, and that the corresponding benefits are properly reflected in the Company's claim before such costs are securitized.

3. FASB 109 Tax Expense.

PECO's FASB 109 amount is a future tax obligation PECO's customers must pay for certain tax/book timing differences the tax benefit of which PECO was required by the Commission to flow-through to customers in prior ratemaking decisions. These differences reverse over time and would increase PECO's revenue requirement in the future. Hence, a regulatory asset is recorded in an amount equal to the deferred tax liability. For this proceeding, PECO has requested recovery of \$675.5 million of its FASB deferred tax liability.

The presentation of conflicting evidence by PECO, the OCA, and the PAIEUG on this issue raises many questions that can only be answered with further hearings in the restructuring proceeding.

This record cannot support finding that PECO's claim for this amount is presently known and measurable.

IX. IPL STANDING

PECO questions IPALCO's standing in this proceeding. IPALCO and PECO both own generation. They both may be soon competing for customers.

On December 3, 1996 the Commonwealth officially indicated to the world that Pennsylvania's retail electric generation market would be competitive by passing the Act. All competitors have a direct interest in how this Act is implemented. To deny IPL standing in this case would be inconsistent with the letter and spirit of the Electricity Generation Customer Choice and Competition Act. It would also send a message to all competitors that they would not be even tolerated in the Commission's proceedings, let alone be given a fair hearing.

X. LEGAL ISSUES

At this juncture, some preliminary, brief comments about two legal issues are warranted. Those issues are the contradictory assertions that disallowance of stranded investment recovery would constitute an unconstitutional taking of property and allowance of stranded investment recovery would constitute an unconstitutional interference with interstate commerce. Both constitutional arguments are weak especially at their extremes. Would really the disallowance of \$1.00 of stranded investment or the allowance of \$1.00 of stranded investment recovery violate constitutional protections? No is the answer in my opinion. Could more major disallowances or allowances of stranded investment recovery raise serious constitutional questions? As PECO's restructuring proceeding unfolds, there will be time enough to answer fully these legal questions.

This opinion does not address many of legal questions that the parties advanced. It does not do so, because the principal constitutional and statutory arguments of all the parties could be more usefully commented upon when the decision in PECO's restructuring case is issued. At that point, legal discussion will be more fruitful since certain facts will have been developed that could influence both statutory interpretation and constitutional reasoning on issues like takings and burden on interstate commerce. Of course anything said by this Commission on constitutional questions is just a comment and not a decision as the courts have plenary authority over constitutional challenges.

The parties, nonetheless, are requested to move and the assigned Administrative Law Judges are requested to consolidate into the record of PECO's restructuring case all evidence introduced in this case on the issue of regulatory compact or other issues that would help legal analysis and subsequent judicial review.

No matter how this Commission resolves the many questions of law that the parties have advanced, appellate courts will review our legal decisions de novo. Unlike findings of fact that will be overturned only if they are not supported by substantial evidence, this Commission's conclusions of law will receive no deference on appeal.

XI. SETTLEMENT

Many of the parties in this case have armed themselves with an arsenal of legal missiles that are aimed at the Act or each other. Some of these missiles have constitutional warheads. All these legal arguments raise risks for all parties. Is stranded investment recovery in any amount or some amount unconstitutional? Is denial of any amount or some amount of stranded investment recovery unconstitutional? These are just some of the legal questions raised by the parties.

The parties can pursue their legal claims and pursue litigation before this Commission in which case five commissioners and perhaps ultimately nine Supreme Court Justices will make decisions that profoundly will affect shareholders, competitors, and consumers. That is a very risky strategy for all concerned.

An alternative is settlement. Settlement will allow the parties to decide their own fate. Settlement will require both flexibility, common sense, and even courage. Leaders must have enough courage to say yes to a deal that gives nobody everything and to defend the outcome as reasonable to their constituencies.

I urge all parties to settle this case as well as PECO's general restructuring proceeding. Settlement is in your interest as well as the interest of the Commonwealth.

CONCLUSION

When I early and often urged the repeal of state laws establishing electric generation monopolies, I recommended that the necessary transition from electric monopolies to full competition begin as soon as possible so that the transition would end as soon as possible. I did so, because consumers and

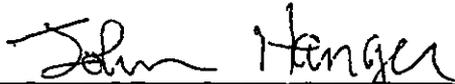
generation providers will have the full benefits of competition only when the transition is completed.

Yet, there will be benefits for consumers and generation providers even during the transition required by the Electricity Generation Customer Choice and Competition Act ("Act"). For example, if made final, the Electric Pilot Programs Preliminary Orders would create savings for many customers of 10% and perhaps as much as 15% if the electric market is robustly competitive. Those pilots will allow more than 250,000 customers to realize savings by November.

Despite the clear benefits that electric competition will create for Pennsylvania's families and business, some consumers attacked the Electricity Generation Customer Choice and Competition Act ("Act") at the public input hearings in this case. Those witnesses should remember that, if the Act had not been enacted, there would be no fight today about how much the rate decrease should be for PECO customers. Moreover, those witnesses should remember that if the Act was repealed tomorrow, PECO's customers would still pay for 100% of PECO's stranded costs. Those costs are in rates and would have remained in rates under the old monopoly laws to be paid by consumers over the next 20 to 30 years. Electric rates in the PECO service territory, therefore, would have remained substantially above state and national average levels for at least that long. Consumers should welcome some debates.

Finally, the record in this case requires the denial of PECO's request to securitize \$3.773 billion. The record also requires approving securitization of approximately \$1.1 billion. This amount represents approximately 15% of PECO's total stranded cost claim of \$6.8 billion.

May 8, 1997
DATE


JOHN HANGER, COMMISSIONER

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held January 15, 1998

Commissioners Present:

John M. Quain, Chairman, Joint Concurring & Dissenting Statement attached
Robert K. Bloom, Vice Chairman, Joint Concurring & Dissenting Statement attached
John Hanger
David W. Rolka
Nora Mead Brownell

Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code and Joint Petition for Partial Settlement R-00973953

Petition of Enron Energy Services Power, Inc., for Approval of an Electric Competition and Choice Plan and for Authority Pursuant to Section 2807(e)(c) of the Public Utility Code to Serve as the Provider of Last Resort in the Service Territory of PECO Energy Company P-00971265

OPINION AND ORDER

(Restructuring Reconsideration Order)

BY THE COMMISSION:

By Motion adopted on December 11, 1997, and by Opinion and Order entered on December 23, 1997, this Commission approved a Restructuring Plan for PECO Energy Company (PECO) based upon modifications to PECO's original Application in this proceeding. Presently before this Commission for review are six (6) Petitions for Reconsideration, Clarification, and/or Amendment of the December 23, 1997 Order individually filed on January 7, 1998, by: (1) PECO, (2) Enron Energy Services Power, Inc., and Enron Power Marketing, Inc., (individually: EESPI and EPML, or collectively: Enron) (Enron Petition), (3) the Office of Consumer Advocate (OCA), (4) the Consumer Education and Protective Association (CEPA), the Tenant Action

Group (TAG), the Association of Community Organizations for Reform Now (ACORN), and John W. Long, (collectively: CEPA) (CEPA Petition), (5) the Philadelphia Area Industrial Energy Users Group (PAIEUG), and (6) New Energy Ventures (NEV).

Brief History of the Proceedings¹

Effective January 1, 1997, the Electricity Generation Customer Choice and Competition Act (Act), 66 Pa. C.S. §§2801, et seq., amended the Public Utility Code (Code), 66 Pa. C.S. §§101, et seq., by adding Chapter 28. Chapter 28 restructured the provision of retail electric service within the Commonwealth. Section 2806 of the Act requires all jurisdictional electric utilities (EDCs) to file restructuring plans for review and approval by the Commission. The Act established a nine-month review process for an EDC's restructuring plan. On January 24, 1997, at Docket No. M-00960890, F0005, this Commission established a schedule for filing restructuring plans. On February 13, 1997, the Commission directed that all restructuring plan filings be accompanied by specific data. (Retail Access Pilot Program - Guidelines, Docket No. M-00960890, F0003).

On April 1, 1997, PECO filed the subject Application for Approval of its Restructuring Plan. PECO's Restructuring Plan requested that this Commission approve its proposed unbundling of rates, competitive transition charges (CTCs), and specific tariff provisions to ensure customers have direct access to all licensed electric generation suppliers. Further, PECO requested recovery of \$6.8 billion of transition and stranded costs. Finally, PECO asked for approval of a plan to meet its universal service obligations, of a mechanism to recover the costs of its universal service obligations, and of a proposed consumer education program.

¹ This section is adapted in large measure from this Commission's December 23, 1997 Order in these proceedings. For a detailed history of the proceedings, see that Order.

The proceeding was assigned to Administrative Law Judges (ALJs) Marlane Chestnut and Charles Rainey. Rate protests were filed by various parties. The OCA, the Office of Small Business Advocate (OSBA), and this Commission's Office of Trial Staff (OTS) entered appearances. Formal Complaints were filed by CEPA, TAG, the Action Alliance of Senior Citizens (AASC), Mr. Long, PAIEUG, and ACORN. The AASC subsequently withdrew its Complaint.

Intervenors included the Hon. Vincent J. Fumo, Jr., Senator, 1st State Senatorial District (Sen. Fumo), Indianapolis Power and Light Co. (IPL), the Environmentalists,² Delmarva Power and Light Co., t/d/b/a Conectiv Energy (Conectiv), Enron Corp. (an affiliate of EESPI and EPMI), DuPont Power Marketing (DuPont), the Mid-Atlantic Power Supply Association (MAPSA), the Delaware Valley Schools Energy/Utility Consortium (DVSEUC), Allegheny Power Company (APC), American Energy Solutions (AES), the Department of the Navy (Navy), the American Association of Retired Persons (AARP), Lance Haver, CNG Energy Services (CNG), the Municipal Intervenors Group (MIG), NEV, the Pennsylvania Petroleum Association (PPA), Ethan Giddings, the Center for Energy and Economic Development (CEED), Duke Energy Trading Market, LLC, (Duke), the Pennsylvania Retailers' Association (PRA), NorAm Energy Management, Inc. (NorAm), Vastar Power Marketing, Inc. (Vastar), Electric Clearinghouse, Inc. (ECI), ERI Services, Inc. (ERI), the Pennsylvania Association of Plumbing, Heating and Cooling Contractors (PAPHCC), Albert M. Benincasa, QST Energy, Inc. (QST), and Southeastern Pennsylvania Transportation Authority (SEPTA). CNG ultimately withdrew as an individual participant but continued to participate through MAPSA. Comments were filed by the Hon. Stewart Greenleaf, Senator, 12th District, Rufus L. Miley, and Nicholas J. DiMarino.

² The Environmentalists consist of the Delaware Valley Citizens' Clean Air Council (Clear Air Council), the Sierra Club, Citizens Action, Pennsylvania Public Interest Research Group (PennPIRG), Grass Roots Alliance for a Solar Pennsylvania (GRASP), Nonprofit Energy Savings Investment Program (NESIP), and the Philadelphia Solar Energy Association (PSEA).

PECO and Sen. Fumo, CEPA (on behalf of itself, TAG, ACORN, and Mr. Long), Mr. Haver, the OTS, the OCA, the OSBA, PAIEUG, AARP, and the Navy (Joint Signatories) signed a Partial Settlement. On August 27, 1997, the Joint Signatories filed a Joint Petition for Partial Settlement of PECO's Proposed Restructuring Plan and Application for a Qualified Rate Order (Settlement Petition) in support of the Partial Settlement.

On October 7, 1997, EESPI³ filed its Petition for Approval of an Electric Competition and Customer Choice Plan and for Authority Pursuant to Section 2807(e)(3) of the Public Utility Code to Serve as the Provider of Last Resort (PLR) in PECO's Service Territory at Docket No. P-00971265. By Order entered on October 9, 1997, EESPI's PLR Petition was consolidated with PECO's restructuring proceeding as captioned above.

On October 14, 1997, the Presiding Officers covered extensively this Commission's instructions relative to the establishment of a complete record, noting in particular that there would be one decision addressing the proposed Partial Settlement, the EESPI PLR Petition, and all unresolved issues.

On October 21, 1997, PECO, PAIEUG, Sen. Fumo, Mr. Haver, AARP, CEPA, TAG, ACORN, Mr. Long, the OCA, the OSBA, and the OTS filed Petitions for Reconsideration of the October 9 Order. On November 6, 1997, this Commission entered an Opinion and Order denying the relief requested in the October 21 Petitions for Reconsideration and offering, instead, an option to extend the date for Commission action until January 30, 1998. The November 6 Opinion and Order reiterated and clarified that the scope of the issues to be addressed included the Restructuring Plan, the proposed Partial Settlement, the EESPI PLR Petition, and all unresolved issues. The schedule was

³ On October 7, 1997, EESPI filed an application at Docket No. A-110059 for authority to provide service as a licensed electric supplier.

not extended, however, due to the filing of timely objections by Conectiv, NEV, and MAPSA.

The record in this proceeding contains a transcript of 2280 pages, as well as the statements and exhibits admitted into the record and the briefs of the parties. By Order entered on December 23, 1997, this Commission denied both the Partial Settlement and the EESPI PLR Petition. In so doing, the Commission rejected EESPI's contingency plan as well as the Partial Settlement. PECO was directed to make a compliance filing within twenty (20) days of the date of entry of the December 23, 1997 Order.

The instant six Petitions for Reconsideration were filed on January 7, 1998. PECO raises concerns regarding the stranded cost calculation, consumer education, and customer choice enrollment. The OCA raises concerns on the issues of stranded costs, customer rates, universal service, customer education, and consumer protections. PAIEUG asserts that the December 23, 1997 Order creates great uncertainty with respect to PECO's restructuring and requests reconsideration of the Order in view of the customer benefits that were contained in the Partial Settlement. EESPI addresses cost and stranded cost allocations, PECO's mitigation efforts, and unbundling. CEPA, *et al.*, seek reconsideration or clarification regarding the generation rate for residential customers who do not chose an alternative generation supplier, consumer protection, and funding for universal service and customer education. NEV expresses concern on the issue of the appropriate discount rate.

Answers to the Petitions were individually filed by PECO, EESPI and EPML, the OCA, MAPSA, PAIEUG, NEV, Conectiv, DVSEUC, and SEPTA.

Discussion

At this stage in the proceeding, the six January 1998 Petitions for Reconsideration are seeking relief following our December 23, 1997 Order. The Code

establishes a party's right to seek relief following the entry of final decisions pursuant to Section 703 of the Code, 66 Pa. C.S. §703, relating to rehearings and rescission and amendment of orders. Subsection 703(g) provides that:

(g) Rescission and amendment of orders.--The commission may, at any time, after notice and after opportunity to be heard as provided in this chapter, rescind or amend any order made by it. Any order rescinding or amending a prior order shall, when served upon the person, corporation, or municipal corporation affected, and after notice thereof is given to the other parties to the proceedings, have the same effect as is herein provided for original orders.

Further, such requests for relief must be consistent with Sections 5.572 of our Regulations, 52 Pa. Code §5.572, relating to petitions for relief following a final decision.

Additionally, consistent with Subsection 703(g) of the Code, *supra*, Section 5.572 of our Regulations, *supra*, and judicial and administrative precedent, the standards for a petition for relief following a final decision were set forth in *Duick v. PG&W*, 56 Pa. P.U.C. 553 (December 17, 1982) (*Duick*). *Duick* held that a petition for reconsideration under Subsection 703(g) may properly raise any matter designed to convince us that we should exercise our discretion to amend or rescind a prior Order, in whole or in part. Furthermore, such petitions are likely to succeed only when they raise "new and novel arguments" not previously heard or considerations which appear to have been overlooked or not addressed by us. (*Duick*, p. 559.) The Commonwealth Court case, *AT&T v. Pa. PUC*, 568 A.2d 1362 (Pa. Cmwlth. Ct. 1990), further elucidated the standards for rehearing, reconsideration, revision, or rescission.

In our opinion, the six Petitions for Reconsideration raise generally narrow issues that do not challenge the balance or direction of our December 23, 1997 Order. We believe that they properly raise matters designed to convince us that we should exercise our discretion to consider clarification or amendment, in part, of our

December 23, 1997 Order. Accordingly, we shall consider the instant Petitions on their merits.

A. Issues Related To Stranded Costs

1. Net Plant.

a. Reallocation of \$98.9 million from transmission and distribution to generation. At page 80 of the December 23, 1997 Order, we generally adopted PECO's quantification of net generating plant in service. PECO is correct that the December 23, 1997 Order mistakenly neglected to include PECO's reallocation of \$98.9 million of common and general plant from the transmission and distribution functions to the generation function during the rebuttal round of the proceeding. PECO made this correction to Exhibit ABC-1, Revised, in response to the recommendations of several other parties. We agree with PECO and the other parties that the subject \$98.9 million is generation-related plant and should not be recoverable through transmission and distribution rates. This correction increases PECO's stranded costs by \$98.9 million.

b. Plant No Longer Used and Useful. At page 81 of the December 23, 1997 Order, we adopted the recommendation of OCA witness La Capra to reduce net plant by \$35.4 million to reflect plant no longer used and useful that should be retired and not carried on the company's books. The conclusion that plant no longer used and useful cannot be considered for recovery as a stranded cost is correct. PECO, however, properly points out that the adjustment to reduce net plant by \$35.4 million requires an offsetting adjustment to reduce an equivalent value of accrued depreciation. These two adjustments balance each other out, so no adjustment to net plant is necessary. This correction increases PECO's stranded costs by \$35.4 million.

These two net plant adjustments result in a total increase of \$134.3 million in the book value of PECO's stranded assets and an equal increase in PECO's recoverable stranded costs.

2. Deferred Fuel Expense:

a. Fuel Expense Through Energy Cost Adjustment (ECA) Roll-In on December 31, 1996. At page 71 of the December 23, 1997 Order, we granted recovery of a regulatory asset for deferred fuel expenses and nuclear performance incentives actually recognized on PECO's books as of December 31, 1996, the date at which the ECA was rolled into base rates. The May 22, 1997 Qualified Rate Order (QRO) granted recovery of this expense. Since the QRO is irrevocable, the same recovery was authorized in the December 23, 1997 Order. The December 23, 1997 Order characterized this item as recovery of \$96.162 million for the underlying expense and interest to the net present value date of December 31, 1998.

PECO properly points out that the QRO, in fact, categorized the total recoverable amount as \$96.162 based on a quantification of interest only through June 30, 1997, not the relevant net present value date in this proceeding of December 31, 1998. PECO is correct that the recoverable amount would be \$109.33 million if interest were calculated to the net present value date of December 31, 1998, and that OCA witness La Capra accepted this quantification. We shall accept this correction which increases PECO's stranded costs by \$13.2 million.

b. Fuel Expense Post December 31, 1996. In the December 23, 1997 Order, we denied PECO's recovery of unrecovered fuel expense beyond December 31, 1996, based on the recommendations of OCA witness La Capra and PAIEUG witness Kollen. Those witnesses argued, and we agreed, that the reconciliation provisions of an ECA permit recovery only based on actual experience and documentation of the costs. Future energy costs are inherently not "known and measurable" at this point in time, could

not now be granted pursuant to an ECA, and, therefore, cannot qualify as recoverable stranded costs under the Act. The December 23, 1997 Order denied PECO's request for stranded cost recovery of \$22 million for each of 1997 and 1998 and for \$22.7 million for each year through the conclusion of the proposed transition period, December 31, 2005.

In its Petition for Reconsideration, PECO revises its prior claim instead to request recovery of \$29.4 million for unrecovered fuel expense through November 30, 1997, and to allow recovery for additional fuel expense through December 31, 1998, as part of the CTC reconciliation proceedings. PECO has not asked for reconsideration of the denial of recovery for fuel costs beyond December 31, 1998.

At the outset, as several parties pointed out in their Answers to PECO's Petition, a petition for reconsideration of a final order is not an appropriate vehicle for presenting a new proposal or new evidence not in the record of the proceeding.⁴ The decision in this case, whether within the December 23, 1997 Order or upon this reconsideration, can be based solely on the proposals and the record of this proceeding. For this reason, PECO's request for \$29.4 million for unrecovered fuel expense through November 30, 1997, and its proposal to include additional fuel expense through December 30, 1998, in the CTC reconciliation must be denied. In addition, PECO's presentation of additional "evidence" concerning partial-year 1997 fuel costs through the Affidavit of Alan Cohn is a post-record submittal and cannot be considered in this proceeding.

By way of further clarification, we also will address the underlying issue. PECO requested, and we approved, the elimination of PECO's ECA pursuant to an Order adopted on May 22, 1997 at Docket Nos. P-00961126 and R-00963838 (the Roll-in Order). In the Roll-in Order, we explicitly defined calendar year 1996 fuel costs not fully

⁴ We note that PECO's proposal is not new and novel under the *Duick* standard, *supra*, in that PECO could have made this proposal on the record in this proceeding.

recovered due to the elimination of the ECA as a regulatory asset typically recoverable under current regulatory practice and, therefore, recoverable as stranded costs in this proceeding. In this proceeding, we have determined the recoverable amount to be \$109.33 million, as discussed in this Opinion and Order, *supra*.

In contrast, we explicitly declined to identify post-1996 fuel expenses as recoverable stranded regulatory assets. Instead, we granted PECO the right "to defer and to seek to recover" such costs in this proceeding. In the Roll-in Order, we granted PAIEUG's request for an amendment of this Commission's Tentative Order, issued on December 19, 1996, to clarify that "the actual figure (for recovery of post-1996 fuel expenses), if it is to be allowed at all, will be set in PECO's restructuring proceeding." The Roll-in Order specified that, consistent with our long-standing practice, granting PECO the right to defer the expense for accounting purposes has no direct ratemaking implication. PECO's characterization in its Petition that the Roll-in Order "confirmed" the recoverability of 1997 and 1998 fuel costs is insupportable. Upon approval of the elimination of the ECA and the roll-in of variable energy costs into base rates as of December 30, 1996, PECO relinquished the right to have its fuel costs reconciled automatically because the annual fuel cost expense was subsumed into rates.

The Roll-in Order explicitly found that the rolled-in rates would be considered the rates subject to the rate cap that went into effect on January 1, 1997. PECO's rates were capped at January 1, 1997 levels for 54 months from January 1, 1997, but for exception(s) to the rate cap under the Act. Section 2804(4)(III)(D) of the Act provides that a significant increase in unit fuel cost such that the utility would not be able to earn a fair rate of return could be an exception to the rate cap.

PECO does not assert that its fuel expenses constitute a valid exception to the rate cap, however. In its Answer to PECO's Petition, the OCA recalled OCA witness Catlin's testimony that recovery of 1997 and 1998 fuel costs would be inappropriate while

PECO remained under traditional regulation without a demonstration that its existing rates are inadequate. (OCA Stmt. No. 3 at 17.) PECO merely asserts that it is entitled to recover an alleged underrecovery of its fuel costs despite the fact that PECO eliminated its fuel cost adjustment clause in 1996. PECO cannot, by definition, both subsume its fuel expense into base rates and request an annual reconciliation of fuel costs. Granting stranded cost recovery for fuel costs after the December 30, 1996 effective date of the roll-in and the rate cap would circumvent the rate cap and render the end of the reconciliation provisions meaningless. For these reasons, the relief sought through PECO's request for reconsideration of this issue is denied.

3. Deferred Limerick Common Plant.

On page 76 of the December 23, 1997 Order, we authorized recovery of the same \$175.8 million for deferred Limerick Common Plant expense as was authorized pursuant to the May 22, 1997 QRO. PECO correctly identifies a Commission error in identifying this amount as \$158.3 million in the stranded cost recovery tabulation total on page 101 of the Order. Correction of this error increases stranded costs by \$17.5 million.

4. SFAS 106 Deferred Costs.

PECO claimed recovery of \$32.615 million for the unamortized balance of 1993 and 1994 deferrals that had previously been included in rates pursuant to a 1994 settlement agreement. We granted full recovery of this amount on a net present value basis of \$20.394 million as of December 31, 1998. No party seeks reconsideration of this issue.

We denied PECO's additional claim for \$67.965 million for stranded costs related to its 1994 early retirement programs (VSIP/VRIP expenses). PAIEUG witness Kollen testified these expenses would not have been recoverable under traditional ratemaking. We adopted generally the analysis of witness Kollen that stranded cost

recovery, at this time, of the one-time, non-recurring 1994 expenses would constitute inappropriate, single-item, retroactive ratemaking.

In its Petition, PECO asks us to reconsider our conclusion that the VSIP/VRIP expenses were never previously included in rates. PECO asserts that the VSIP/VRIP expenses were, in fact, included in rates pursuant to a 1994 settlement at Docket No. R-00922479. In direct testimony, PECO stated that "the [1994] settlement provided that PECO would be permitted to increase its electric base rates by \$25 million to fully fund its SFAS 106 obligation." (PECO Stmt. No. 3 at 32-34.) Additionally, PECO indicated that the settlement provided that the SFAS 106 costs deferred by PECO for the years 1993 and 1994 pursuant to the Commission Order approving the 1994 settlement would be amortized over an 18-year transition period and that such amortization "will be subsumed in the rates prescribed" by the settlement. PECO explicitly indicated that "a revenue stream to fund [the transition] expense has been provided as part of the \$25 million base rate increase implemented pursuant to the settlement. . . ." (PECO Stmt. No. 3, p 33.)

We again have reviewed the record in this proceeding, the 1994 settlement, and related Commission Orders, and we conclude that the December 23, 1997 Order permits PECO full recovery of all appropriate SFAS 106 costs. PECO has provided no support in the record of this proceeding that the VSIP/VRIP expenses require any additional recovery. We reaffirm our conclusion that the VSIP/VRIP expenses reflect one-time transition costs during 1994 for which present recovery would constitute inappropriate single-issue and retroactive ratemaking. In any event, the settlement fully incorporated all 1993 and 1994 transition costs, and no additional recovery is appropriate.

For the foregoing reasons, PECO's request for relief on this issue is denied.

5. SFAS 106 Trust Fund Earnings.

In its Petition for Reconsideration, PECO claims that it is entitled to retain all trust fund earnings as part of the basic actuarial funding stream for the trust fund expenses.

In the December 23, 1997 Order, we adopted PAIEUG witness Kollen's recommendation to recognize a regulatory liability of \$151 million for SFAS-106 trust fund earnings. We reaffirm our conclusion that PAIEUG witness Kollen's testimony fully supports this adjustment. (PAIEUG Stmts. Nos. 3, p. 33, and 3S, p. 18.)

The December 23, 1997 Order should, however, be clarified on this issue. The December 23, 1997 Order does not eliminate trust fund earnings in support of the underlying expense, as PECO asserts. Rather, the December 23, 1997 Order establishing a regulatory liability for trust fund earnings recognizes the importance of those earnings. PECO's argument does not appear to accept two basic requirements for a determination of recoverable net stranded costs in this proceeding, however. First, this proceeding establishes a demarcation date of December 31, 1998, after which only PECO will be responsible for generation-related expenses. Second, the determination of recoverable stranded costs must reflect the net present value of those costs as of December 31, 1998. Our finding that PECO has a regulatory liability related to trust fund earnings properly incorporates these requirements of the Act. Consumers should receive credit for the present value of that portion of trust fund earnings associated with consumer funding responsibility through December 31, 1998. PECO's argument that it should be permitted to retain trust fund earnings in order to account for future inflation and cost escalation is inconsistent with a determination of the net present value of its stranded costs and the fact that it is responsible for the share of funding after January 1, 1999. The only evidence of record relative to the amount of this adjustment is PAIEUG's figure of \$151 million. PECO argued against any adjustment and suggested no alternative calculation for the adjustment.

Thus, the regulatory liability of \$151 million is affirmed and should be considered as an offset to recoverable regulatory assets.

6. Pension Fund Overcollection.

The December 23, 1997 Order adopted the recommendations of PAIEUG witness Kollen and Navy witness Smith to establish a regulatory liability to reflect \$217.347 million of overfunded pension plans. PECO does not dispute that the overfunding exists but argues that the overfunding can quickly dissipate based on reduced performance of the stock market. Additionally, PECO argues that it has no ability to withdraw the overfunded sums to compensate for the regulatory liability adopted by us.

In its Petition, PECO indicates that it has included only \$200,000 of annual pension expense as an operating expense in its market valuation instead of \$13.4 million that would be required as annual pension contributions in the absence of the current overfunding. PECO argues that this reduced future expense is "credited" to consumers as decreased future operating expenses, increasing the value of its generation assets and limiting the amount of stranded costs.

While we continue to agree that overfunding of pension expense can be credited to consumers as a regulatory liability, we are persuaded to reconsider our decision. PECO's approach is reasonable under the circumstances because PECO has provided an alternative methodology to credit consumers with the economic benefit of the overfunding through the increased valuation of its stranded assets. We decline to retain the regulatory liability and adopt a new adjustment to increase the pension funding expense to \$13.4 million, thereby requiring a recalculation of the market value of PECO's generating assets at this stage of the proceedings.

Thus, we shall grant PECO's request for relief on this issue, resulting in an increase in stranded costs of \$217.347 million.

7. SFAS 109 Deferred Taxes.

In the December 23, 1997 Order, we granted PECO's claim for \$1.687 billion as a recoverable regulatory asset for deferred taxes. PECO calculated the amount as a nominal value but did not request any return on the recoverable amount. PECO did not present all of its stranded cost claims on a net present value basis in its Restructuring Plan but argues in its Petition that it reached a comparable result by not requesting a return on certain claims.

In their Petitions, PECO, the OCA, and PAIEUG point out that we concluded that the Act requires all stranded cost claims to be stated on a net present value basis and adopted an approach that grants the same return for all recoverable stranded assets. PECO, the OCA, and PAIEUG properly conclude that the December 23, 1997 Order, therefore, overstates PECO's stranded cost by awarding the nominal value of the claim as well as a return on it. We note that the specific analytic framework suggested by the OCA for properly quantifying the SFAS 109 claim comports with PECO's presentation of the issue. In its Answer to the Petitions, PAIEUG indicates its support of PECO's and the OCA's request and agrees with PECO that the adjustment should be \$471 million.

We shall grant relief on this issue and adopt this adjustment.

8. Reallocation of Administrative and General Costs to Generation.

The OCA, Enron, and NEV request reconsideration of the December 23, 1997 Order concerning the impact on stranded costs of reallocations from the transmission and distribution function to the generation function. On page 62 of the December 23, 1997 Order, we concluded, subject to the accepted compliance filing, that the reallocation would result in an increase in PECO's stranded costs of approximately \$460,691,000, although the precise number would be established upon acceptance of PECO's compliance filing.

If administration and general (A&G) expenses are reallocated to generation, they must be considered in the same way that any operating expenses are considered to assess the market value of the generating asset. Increased operating expenses reduce market value and, therefore, increase stranded costs. The requested modification on this issue is, therefore, denied.

B. Issues Other Than Stranded Costs.

1. Universal Service Cost Recovery.

The OCA and CEPA seek reconsideration of the decision retaining universal service cost responsibility as it is in existing rates. We agree with PAIEUG in its Answer that the Petitions raise no new arguments not already fully raised and duly considered on this issue and that relief requested is, therefore, inappropriate.

2. Market Power Investigation.

CEPA argues that we have not conducted a market power analysis pursuant to Section 2811(a) and (b) of the Act to consider whether the market will, in fact, be competitive. This request misunderstands Section 2811 and is, therefore, denied. Section 2811 establishes no preconditions to approval of a restructuring plan. Any party or the Commission may initiate a market power investigation pursuant to Section 2811 if there is good cause to believe that a market power problem exists. Moreover, we agree with PECO's Answer that CEPA should have presented evidence on this issue during the proceeding if CEPA was concerned about PECO's market power inhibiting the development of a competitive market. We reaffirm our conclusion that the Restructuring Plan adopted by the Commission will create a vibrant, competitive market.

3. Termination Upon Nonpayment of Supplier Bill.

The OCA and CEPA request clarification that PECO may not disconnect a customer from the grid for failure to pay a supplier bill. We do not believe that any clarification is necessary on this issue because PECO has acknowledged in its Answer that the Commission has clearly adopted the rule in other proceedings that a customer can only be disconnected from the grid for nonpayment of an EDC charge or provider of last resort charge for generation services.

4. Switching Fees.

The OCA is correct that the December 23, 1997 Order mistakenly omitted specific discussion of switching fees. Reconsideration is granted of this omitted issue. We shall adopt the recommendation of OCA witness Alexander that a switching fee is inappropriate during the early stages of customer choice and direct PECO to consider the guidelines proposed in OCA Statement. No. 5S at 10-11 in proposing any switching fee in the future.

5. Consumer Education.

PECO seeks reconsideration and clarification regarding its consumer education proposal. Specifically, PECO urges reconsideration of the December 23, 1997 Order to the extent that we discussed its budget as a three (3) year budget of \$24 million. PECO also urges reconsideration or clarification relating to our discussion and direction that 65% of its proposed budget be allocated to a statewide consumer education program.

In its Petition, PECO argues that its proposal contained a four (4) year budget which provided for \$24 million. That proposal included \$5.6 million allocated for consumer education activities for 1997. According to PECO's Petition, PECO has

devoted approximately \$1 million of its 1997 budget to statewide programs. Accordingly, \$18.6 million of its proposed budget remains for the years 1998-2000.

Based on the foregoing, PECO seeks approval of its proposed consumer education program on the basis of a four-year, \$24 million dollar budget or, in the alternative, a budget of \$18.6 for the period of 1998-2000. PECO also seeks clarification that the precise allocation of its budget to the statewide program be reserved to a separate proceeding establishing a statewide consumer education program.⁵

The OCA seeks reconsideration of our discussion of PECO's consumer education proposal to the extent that the OCA requests the inclusion of consumer representatives from regions in addition to PECO's service territory. CEPA seeks reconsideration of our discussion of PECO's consumer education proposal and states a concern that PECO's ratepayers may be called upon to fund consumer education costs for customers outside of PECO's service territory. CEPA agrees that PECO customers may be required to pay their proportional share for a statewide program but that a determination of the scope of the statewide program is outside of the scope of this proceeding.

We will grant, subject to review of PECO's compliance filing, PECO's request for relief relating to the budget for its consumer education program. As PECO has stated, its proposed budget of \$24 million was stated on a four-year basis. We note, however, that PECO's Petition for Reconsideration states that \$5.6 million had been allocated for consumer education in 1997 without indicating the amount actually spent. It, therefore, is not clear whether its remaining budget is actually \$18.6 million for the period 1998-2000, or some greater figure. In addition, the amount spent must have been expended on consumer education as contrasted with marketing or public relations

⁵ *Creation and Implementation of a Statewide Consumer Education Program for Electric Restructuring in the Commonwealth of Pennsylvania, Docket No. M-00981036, adopted on January 15, 1998 (Consumer Education).*

activities related to this proceeding. Accordingly, PECO must provide an accounting of its 1997 consumer education expense in the compliance filing sufficient to enable us to determine its consumer education funding for the period 1998-2000.

In addition to recognizing our misstatement of the budget time frame, we recognize that both PECO and CEPA have raised a legitimate question relating to setting the allocation between the statewide effort and local efforts in this proceeding. Although we believe that a 65%-35% allocation of funds to statewide effort and local effort, respectively, is an appropriate and justified ratio, we agree that the precise allocation can and will be addressed in our statewide proceeding.

Finally, we note that in our discussion of the committee to oversee the content of the statewide consumer education program, we provided for representation on that committee for the Executive Director of the Energy Coordinating Agency of Philadelphia. The OCA has suggested that there should be direct representation of consumers from areas in addition to Philadelphia. As discussed in *Consumer Education, supra*, the list of representatives for the committee was not intended to be exclusive. We will entertain comments in that proceeding addressing appropriate members to serve on the committee. We will also retain authority to expand committee membership as circumstances warrant.

6. March 1, 1998 Open Enrollment Date.

On page 47 of the December 23, 1997 Order, we directed PECO to initiate an open enrollment period beginning March 1, 1998 for the 66% of PECO consumer load eligible to shop on January 2, 1999. In its Petition, PECO requests that the March 1, 1998 start date be reconsidered and extended for several months. PECO asserts that beginning enrollment on March 1, 1998, would deny PECO customers the benefit of an orderly and coordinated education outreach program and precede final resolution of generic issues and rulemaking proceedings affecting the procedures and regulations that will be in effect.

We shall reconsider the March 1, 1998 enrollment commencement date and direct that PECO commence enrollment on April 27, 1998. All parties should note the "enrollment" is only the act of volunteering by informing PECO, directly or through a supplier, that the consumer wishes to participate in the phase-in. Customers need not select a supplier in order to obtain a slot in the program.

We shall grant this extension at PECO's request in order to give PECO more time to prepare for enrollment although we do not agree that an extension is necessary for effective consumer education or to permit all generic proceedings to be completed. The April 27 commencement date will provide sufficient advance opportunity for effective preparation and consumer education as well as sufficient time for consumers to shop for a supplier.

As discussed above, relative to *Consumer Education, supra*, a quality consumer education program will be conducted in PECO's service territory. Quality consumer education must occur over an extended, not limited, period of time and will be more effective if conducted while consumers may act on what they have learned.

The conclusion of all generic proceedings is not a pre-condition to the commencement of enrollment. The generic proceedings will not all be concluded by July 1, 1998, in any event. Specific protocols and regulations will continue to be adopted from time to time.

7. Generation Charges for Customers Not Shopping.

The December 23, 1997 Order, at pages 132-134, fully details the terms of service for customers who do not have a competitive supplier.

The OCA and CEPA raise questions in their petitions concerning the rates that PECO may charge for generation services to customers who do not shop. Neither

party has raised new arguments not already considered by us, and reconsideration, therefore, is denied. Some comments are appropriate, however, in order to correct some mischaracterizations and misunderstandings.

PECO, as an EDC, remains a regulated utility and may only offer Commission-approved, tariffed rates. In this proceeding, no party provided evidence that PECO's regulated rates should be reduced under traditional ratemaking. Protected by the statutory rate caps, customers who do not shop remain regulated rate customers of PECO on the same terms and conditions of services unless changed by Commission Order. As summarized on page 46 of the December 23, 1997 Order, the "shopping credit" is not relevant to a customer who does not shop. Customers who do not shop pay the approved tariffed rate divided into unbundled generation, transmission, and distribution charges.

8. Phase-In and Enrollment Issues.

In order to ensure that no further delays are necessary, and in response to the issues raised in the Petitions indicating concern that the enrollment process requires clarification, we will take this opportunity to emphasize and detail the enrollment process that we envision. The compliance filing should reflect these directions.

PECO shall distribute a notification letter and explanatory information to all customers over a period of not more than one week ending on April 13, 1998. The materials shall specify that enrollment in the phase-in is separate from supplier selection. Enrollment forms may be distributed both by PECO and suppliers but may not include a supplier selection. A customer may enroll in the phase-in directly through PECO or through a supplier, but the customer may not select a supplier at the same time.

Customers participating in the pilot program and others representing the first 33% of non-coincidental peak load to volunteer to enroll after the April 27 commencement date may receive competitive supply in the January 1, 1999 phase-in

group. When the 33% threshold is reached for any tariff class, PECO shall send a notification letter to all such customers that they will be in the first phase-in group.

If fewer than 66% of customers in any tariff class are enrolled as of July 1, 1998, PECO shall send a notification letter to all volunteers as of that date who are not in the January 1, 1999 phase-in group that they will be in the January 2, 1999 phase-in group. Enrollment will continue until completed, with additional notification letters sent not less frequently than every two weeks. In such situations, the enrollment will be completely "first-come, first-served," and no lottery will be necessary.

If more than 66% of customers in any tariff class have volunteered as of July 1, 1998, PECO shall have an independent party conduct a lottery to determine which of the customers representing the additional load beyond the January 1, 1999 phase-in group will be included in the January 2, 1999 phase-in group. PECO shall send a letter notifying participants of selection through the lottery not later than July 15, 1998.

In its Petition, PAIEUG requests that we reconsider our participant selection procedure to ensure that all volunteer industrial customers may participate in the first two phase-in groups. Instead of conducting a lottery in the event of overenrollment, PAIEUG recommended that all volunteering customers in each tariff class may participate with a pro rata partial load in order to avoid any competitive disadvantages. (PAIEUG Stmt No. 1, pp. 57-58.) We shall modify the December 23, 1997 Order to reflect PAIEUG's concern as applied to the industrial tariffs in order to avoid any competitive disadvantage.

Participants may notify PECO of a selected supplier any time after receipt of the letter from PECO informing them that they have been included in the phase-in group. The selection shall be made by written notice submitted directly to PECO or through a supplier. All customers shall receive a letter from both PECO and the supplier confirming the selection within 15 days of notice of the customer's choice. The

confirmation letter shall indicate the date that the new supplier service will become effective and when they will receive their first bill. Power will be provided by PECO until a customer selection is implemented. Any participant selecting a supplier by November 1, 1998, will receive energy through their chosen supplier in the first billing cycle following their phase-in date. Failure to choose a supplier by November 1, 1998, does not terminate participation in that phase-in group.

The compliance filing shall include proposed letters inviting enrollment and notification of acceptance in each phase-in group as well as other consumer education materials to be included in the initial mailing notifying customers of the enrollment period and procedures. The letters for residential and small commercial customers shall reflect the considerations in the December 23, 1997 Order, this Opinion and Order, and the other dockets addressing this issue. In particular, the notices shall: (1) Identify and explain the unbundled bill components, including the amount and significance of that customer's shopping credit; (2) List the name, address, phone number and e-mail address of each licensed supplier in fact serving the class of customers; (3) Provide PECO and PUC customer information telephone numbers; (4) Explain the advantage of selecting a supplier by November 1, 1998, as described above; and (5) Explain that failure to choose by November 1, 1998, does not terminate the customer's right to participate in that phase-in group, as described above.

We shall provide comments on the draft letters to PECO as soon as possible after the review of the comments from other parties which are due on or before January 27, 1998. In order to avoid delays, Commission approval will be granted informally, prior to acceptance of the compliance filing itself.

9. Compliance Filing Issues.

PECO did not submit a compliance filing as required by the December 23, 1997 Order and did not submit a request for an extension of the due date until Friday,

January 9, 1998. By Secretarial Letter dated January 13, 1998, we informed PECO and the other parties that the overdue compliance filing was then due on January 20, 1998. While we recognize that some revisions to the compliance filing are now required because of the clarifications, corrections, and relief granted in this Opinion and Order, the relatively modest revisions to the compliance filing can and must be completed by the extended deadline of January 20, 1998.

Other parties will have until January 27, 1998 to submit comments on the compliance filing. We expect to issue a compliance filing Order at Public Meeting of February 5, 1998. We remain committed to expeditious and effective implementation of the approved restructuring plan, and we expect the fullest cooperation from all parties. The compliance filing accepted by this Commission will precisely reflect the intent of the December 23, 1997 Order. Successful implementation of the approved restructuring plan requires well written tariffs and company rules and procedures.

The Petitions and Answers indicate concerns about the proper calculation of the stranded cost that result upon the reallocation of A&G expenses from transmission and distribution functions to the generation function. In the December 23, 1997 Order, we estimated the impact as \$460,691,000, subject to the compliance filing. PECO should calculate the increased stranded investment produced by the allocation of A&G expense to generation assuming that the annual \$38,701,357 A&G expense escalates at the annual gross domestic product (GDP) deflator found in PECO's Statement No. 1. (PECO Exh. TPH-5, p. 6.) PECO should use the discount rate of 7.6% adopted by us at page 89 of the December 23, 1997 Order. Lastly, PECO should exclude the tax gross up by multiplying the resulting present value by .587 to reflect PECO's tax rate of 41.3%. In addition, as noted in the December 23, 1997 Order, PECO is to remove all revenue requirements gross-ups from the A&G reallocation in its compliance filing.

The compliance filing shall calculate the CTC in the manner described in the Order and restated for clarification as follows: (1) The CTC is to be calculated recognizing the monthly receipt of revenue by PECO; (2) The CTC is to be calculated using a 7.47 percent rate of return, inclusive of all revenue requirements; (3) The CTC is to be allocated to each customer class in a manner that does not shift inter-class and intra-class costs and maintains consistency with utility production plant accepted by us in PECO's most recent base rate proceeding. In order to avoid confusion, we note that PECO has provided data suggesting that the Rate R CTC will be no more than 12.57% above the system-wide CTC for each and every year of the transition period; (4) The CTC is to be calculated using a system-wide consumption of 33,569,358 MWh for 1999; and (5) The CTC is to be trued-up annually consistent with Section 2808 (f) of the Act.

Conclusion

For the reasons discussed herein, the Petitions for Reconsideration are granted, and the relief requested is granted, in part, and denied, in part, consistent with this Opinion and Order. Any issue raised in a Petition but which is not expressly addressed or modified pursuant to this Opinion and Order has been duly considered and is hereby explicitly denied. The December 23, 1997 Order shall be modified, clarified, and corrected in accordance with this Opinion and Order. In all other respects, the December 23, 1997 Order shall be affirmed. In summary, the Table at page 101 of the December 23, 1997 Order is revised and restated in the Appendix of this Opinion and Order to reflect the adjustments made pursuant to this Opinion and Order that affect PECO's total recoverable stranded costs. To the extent that numbers have been rounded for the ease of discussion herein and in the Appendix, the compliance filing shall reflect the exact and precise calculations.

Further, PECO shall no longer be required to submit a compliance filing based solely on the December 23, 1997 Order but instead shall submit a compliance filing

based on the December 23, 1997 Order as modified by this Opinion and Order. The compliance filing shall be due on or before January 20, 1998, and shall precisely reflect the balanced considerations reflected in the December 23, 1997 Order as reconsidered, clarified, amended, and corrected by this Opinion and Order. Interested parties may file comments to the compliance filing on or before January 27, 1998.

With the corrections, clarifications, and modifications granted herein, this Commission, PECO, and the other parties to this proceeding, as well as the electric consumers in this Commonwealth, will be well-positioned to begin and implement successfully the difficult task of moving expeditiously and effectively to a full competitive electric generation market; **THEREFORE,**

IT IS ORDERED:

1. That the Petitions for Reconsideration, filed in this proceeding by PECO Energy Company; Enron Energy Services Power, Inc., and Enron Power Marketing, Inc.; the Office of Consumer Advocate; the Consumer Education and Protective Association, the Tenant Action Group, the Association of Community Organizations for Reform Now, and John W. Long; the Philadelphia Area Industrial Energy Users Group; and New Energy Ventures, relative to this Commission's December 23, 1997 Opinion and Order addressing PECO's proposed Restructuring Plan, are granted and the relief requested is granted, in part, and denied, in part, consistent with this Opinion and Order.

2. That this Commission's December 23, 1997 Opinion and Order addressing PECO Energy Company's proposed Restructuring Plan is modified, in part, consistent with this Opinion and Order, and affirmed in all other respects.

3. That PECO Energy Company's compliance filing, together with all necessary data and analyses, is due on or before January 20, 1998, and must actually be

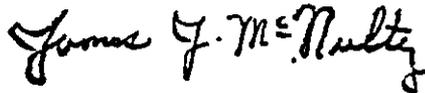
received at the Commission's Office of the Secretary by the close of business on that date.

4. That comments relative to PECO Energy Company's compliance filing are due on or before January 27, 1998, and must actually be received at the Commission's Office of the Secretary by the close of business on that date.

5. That the compliance filing and comments thereto are to be filed with the Commission's Office of the Secretary, with copies to each Commissioner's Office and to the Commission's Bureau of Fixed Utility Services and the Office of Special Assistants. Such filings are to be by hard copy with electronic versions attached consistent with prior directives relative to electronic versions.

6. That PECO Energy Company's compliance filing, together with all necessary data and analyses, shall be served on all active parties of record to this proceeding.

BY THE COMMISSION,



James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: January 15, 1998

ORDER ENTERED: January 16, 1998

Appendix

Replacing page 101 of the Restructuring Order:

<u>Recoverable Regulatory Assets</u>	<u>\$ millions</u> Restructuring Order 12/23/97	<u>\$ millions</u> Restructuring Reconsideration Order	<u>\$ millions</u> Net Change
SFAS 106	20.394	20.394	0
Deferred Fuel Expense	96.162	109.3	13.168
SFAS-109 Deferred Taxes	1,687.1	1,216.3	(470.8)
Compensated Absences	16.587	16.587	0
Miscellaneous Nuclear expenses	0	0	0
Limerick Early Window	65.446	65.446	0
Deferred Limerick Common Plant	158.3	175.8	17.5
Deferred Common Plant for Peach Bottom, Eddystone, & Salem	17.4	17.4	0
Unamortized Loss Reacquired Debt	<u>158.311</u>	<u>158.311</u>	<u>0</u>
SUBTOTAL	\$2.2197 billion	\$1.7796 billion	(\$440.132 million)
 <u>Offsetting Regulatory Liabilities</u>			
Pension Fund Overcollection	(217.347)	0	217.347
SFAS 106 Trust Earnings	(150.861)	(150.861)	0
SUBTOTAL	(\$368.208 million)	(\$150.861 million)	(\$217.347 million)
Non-utility Generating Contracts	0	0	0
Nuclear Decommissioning Expense	0	0	0
 TOTAL SECTION 2808(c)(1) and (2) STRANDED COSTS	 \$1.8515 billion	 \$1.6267 billion	 (\$222.785 million)
 <u>Utility Generation</u>			
Book Value	6.639	6.773	134.3
less market value	3.96	3.96	0
Total Stranded Generation Cost	2.679	2.813	134.3
Fossil Decommissioning Expense	0	0	0
Other Transition Costs	.033	.033	0
Reallocation of A&G Expense to Generation	.461	.461	0
 TOTAL RECOVERABLE STRANDED ASSETS	 \$5.024 billion	 \$4.935 billion	 (\$88.5 million)

REVISED

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

PENNSYLVANIA PUBLIC UTILITY
COMMISSION

v.

PUBLIC MEETING-
JANUARY 15, 1998
JAN-98-C-1
R-00973953

PECO ENERGY COMPANY

PECO Application for Approval of
Its Restructuring Plan and Joint
Petition for Partial Settlement

and

Petition of Enron Energy Services
Power, Inc., for Approval of an
Electric Competition Choice Plan
and for Authority Pursuant to
Section 2807(e)(c) of the Public
Utility Code to Serve as the
Provider of Last Resort in the
Service Territory of PECO Energy
Company

P-00981265

Petitions for Reconsideration or
Clarification of Order Approving
Modified Restructuring Plan
for PECO Energy Company

CONCURRING AND DISSENTING JOINT STATEMENT OF
CHAIRMAN JOHN M. QUAIN AND VICE CHAIRMAN ROBERT K. BLOOM

This matter comes before us on several Petitions for Reconsideration of the Commission's Order entered December 23, 1997. Today, the Commission has ruled on those Petitions, correcting, clarifying, and modifying its order in some respects. Our dissent from the December 23, 1997, Order is a matter of record. We find that we must respectfully concur and dissent with respect to the resolution of the Petitions for Reconsideration as embodied in the Motion of Commissioner Hanger offered today.

We concur with those parts of the Motion that correct certain findings contained in the December 23, 1997, Order. We believe, however, that the Motion is deficient in a number of respects, and therefore we must also dissent.

First, in the proposed treatment of SFAS 106 expenses, the denial of the claimed portion of \$67 million of early retirement expenses is inconsistent with the recognition of the action as a mitigation effort. That denial is also inconsistent with the reduced ongoing allowance for the expense as part of the market valuation for generation property.

Further, the use of earnings on the SFAS 106 trust as an offset for non-SFAS 106 related expenses appears improper from both an accounting and a policy standpoint. Finally, the treatment of SFAS 106 expenses represents a mismatch of present value calculations rather than a matter of overfunding.

We must also disagree with the majority regarding the timing of open enrollment for PECO customers. While the motion grants a delay until April 27, 1998, for enrollment to begin, we believe that this early enrollment period will not afford customers the benefits of Commission-led education programs. We note, however, that these same customers will be funding those programs through their CTC charges. Our preferred position would be to have the initial enrollment period coincide with the expected enrollment periods for the other electric distribution companies in the region. Hence, we prefer a July 1, 1998, open enrollment date.

Finally, the majority does not provide PECO with an adequate time frame for compliance, nor the parties with an adequate period for response to the compliance filing. We would allow a ten day time period from the entry date of the final order on reconsideration for PECO to make its compliance filing. Moreover, we would provide the parties with two weeks thereafter to review the submission and to file comments. The early enrollment date supported by the majority is evidently driving the entire time frame for review, yet this is a review which must be made very carefully. The rates and charges which need to be considered will be in effect for a number of years, and continuing revision of the numbers which may result from unnecessary haste at this point could hinder the ability of other market participants to develop their services and products.

For the foregoing reasons, we concur and dissent on this Motion.

1-15-98

DATE

1-15-98

DATE

John M. Quain

JOHN M. QUAIN
CHAIRMAN

Robert K. Bloom

ROBERT K. BLOOM
VICE CHAIRMAN

SUPPORT FOR PPLICA ADJUSTMENT--FOSSIL DECOMMISSIONING

PP&L Stranded Cost Summary												
(thousands of \$)												
Discount rate is:	7.92%											
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Fossil Decommissioning	0	0	0	0	0	0	0	0	0	0	3,929	4,027
Market revenue	0	0	0	0	0	0	0	0	0	0	0	0
Total Excess/(deficiency)	-	-	-	-	-	-	-	-	-	-	(3,929)	(4,027)
PUC Jurisdiction %	88.43%	91.83%	94.15%	95.92%	96.62%	96.88%	96.88%	96.88%	96.88%	96.88%	96.88%	96.88%
PUC Excess/(deficiency)	-	-	-	-	-	-	-	-	-	-	(3,806)	(3,902)
Sum-year indicated to 2019	(1,041,450)	(1,041,450)	(1,041,450)	(1,041,450)	(1,041,450)	(1,041,450)	(1,041,450)	(1,041,450)	(1,041,450)	(1,041,450)	(1,041,450)	(1,037,644)
Total NPV - Fossil	(269,736)	(291,892)	(315,867)	(341,812)	(369,889)	(400,271)	(433,149)	(468,727)	(507,228)	(548,892)	(593,977)	(638,818)
Notes:	Fossil Decommissioning amount can be found on Exhibit JRS 1A (Revised), pages 20 through 24											
	Jurisdictional percentages and discount rate can be found on Exhibit JRS 1A (Revised), pages 5 through 8.											
	NPV methodology is from PP&L's stranded cost model.											

